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# THE TIED AID CREDIT WAR CHEST OF THE EXPORT-IMPORT BANK OF THE UNITED STATES

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## HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL FINANCE
AND MONETARY POLICY

OF THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

TO

SURVEY TRENDS AND DEVELOPMENTS OVER THE 3 YEARS OF THE FUND'S EXISTENCE AND TO CONSIDER POLICY PROPOSALS FOR THE FUTURE

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SEPTEMBER 13, 1989

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# THE TIED AID CREDIT WAR CHEST OF THE EXPORT-IMPORT BANK OF THE UNITED STATES

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WEDNESDAY, SEPTEMBER 13, 1989

U.S. SENATE, COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS, SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY,

*Washington, DC.*

The subcommittee met at 10:00 a.m., in room SD-538 of the Dirksen Senate Office Building, Senator Paul S. Sarbanes (chairman of the subcommittee) presiding.

Present: Senators Sarbanes, Shelby, Graham, Heinz, and Bond.

## OPENING STATEMENT OF SENATOR SARBANES

Senator **SARBANES**. The subcommittee will come to order. There will be other members joining us in the course of the morning, but given the demands on members' time, I think we would be well-advised to begin the hearing.

This morning the Subcommittee on International Finance and Monetary Policy meets to review the Tied Aid Credit Fund of the Export-Import Bank. The Bank's current authorization for such a Tied Aid Credit Fund expires at the end of this fiscal year, and it is our intention obviously to hold this hearing and then to follow it with action. My sense in the Congress is we want to continue the fund. There will be some consideration on what terms and conditions.

The Tied Aid Credit Fund, commonly referred to as the War Chest, was established in 1986 to counter the foreign tied aid credit programs which had put U.S. exporters at a disadvantage and also to facilitate the negotiation of international agreements to restrict the use of tied aid credits.

U.S. policy has traditionally maintained that goods should be marketed on the basis of quality and service, not subsidies, and since the 1970's the United States has worked within the OECD to discourage reliance on subsidies, and in fact Treasury Secretary Brady in a letter to us said the administration hereby recommits itself to working with Congress to ensure that to the maximum possible degree competition in our export markets focuses on price, quality, and service rather than on the availability of concessional financing.

Notwithstanding the efforts that have been made since the establishment of the Tied Aid Credit Fund a few years ago, the use of tied aid credits has grown. Recognizing the problem, the 1988 omnibus trade legislation directed the Eximbank in conjunction with other appropriate agencies to identify and analyze other countries' practices and to make appropriate recommendations.

Both the analysis and the recommendations have now been submitted to the Congress. The analysis is sobering indeed. Sales lost as a result of our competitors' tied aid credits are estimated by some to be in the range of $400 to $800 million on an annual basis. Other estimates are higher, reaching as much as the $2 to $4 billion range.

What is more, foreign tied aid credits tend to be used in conjunction with projects which have a high proportion of imported capital goods and incorporate high technology levels, creating particularly severe problems for U.S. capital goods and high technology firms. Such projects often found in the critical energy, telecommunications, and transportation sectors have important commercial implications because they tend to set technology standards for future sales.

The establishment in 1986 of the war chest constituted a major policy decision by the United States to respond more vigorously to the credit practices of our competitors. The War Chest was an important factor in bringing about the 1987 OECD agreement to raise the minimum grant element in tied aid credits to developing countries from 25 to 35 percent and to eliminate such credits entirely for industrialized countries.

Nonetheless, the problem is far from solved. Despite the 1987 agreement, it is apparent that our trading partners continue to rely on tied aid credits to the detriment of U.S. exporters.

This morning's hearing provides us with an opportunity to survey trends and developments over the 3 years of the fund's existence and to consider policy proposals for the future. In this connection we look forward to reviewing the recommendations which have just been submitted to the Congress by the Eximbank and the Treasury.

This morning we will hear first from Charles Dallara, Assistant Secretary for International Affairs of the Department of the Treasury, and John Macomber, the President and Chairman of the Export-Import Bank, as an opening panel, and we will then follow it with a panel of distinguished private sector witnesses, Garabed Armenian, Director of Government Finance of Westinghouse, who is testifying on behalf of the National Association of Manufacturers and the Coalition for Employment Through Exports; Frank Kittredge, President of the National Foreign Trade Council; and Stuart Tucker, Fellow of the Overseas Development Council.

We are very pleased to have this distinguished lineup of witnesses, and before turning to Mr. Dallara for his statement, I will yield to Senator Heinz and then to Senator Shelby for any opening statements they might have.

Senator Heinz.

## OPENING STATEMENT OF SENATOR HEINZ

Senator Heinz. Mr. Chairman, thank you. I welcome this opportunity to discuss the tied aid credit problem and the role of the Export-Import Bank. I commend you, Mr. Chairman, for holding these hearings, and I would note that a markup is scheduled in the full committee for materials and amendments having to do with the Eximbank for next week.

I must say that with the United States headed for its sixth consecutive trade deficit over $100 billion, including the unwelcome news that we have for the first time in many decades achieved the dubious distinction of a deficit in services, the discussion of our export finance problem is long overdue.

Now, there are many causes for the U.S. trade deficit, but a particular concern in major LDC markets is subsidized export financing by foreign governments. Developing economies have been major U.S. markets in the past, and they are very important to the future of U.S. trade.

Important as they are, they are being closed to U.S. exporters by tied aid credit offered and made available from foreign governments to their exporters. To underscore this concern, the U.S. deficit with the LDC's represents fully half of our total trade deficit, big as it is.

So while our overall deficit has been shrinking, our LDC trade deficit actually rose 5 percent during the first half of this year. What is worse is that our export financing problems aren't being addressed.

The Eximbank's direct loan program has been cut 90 percent during the 1980's. Efforts by the Banking Committee, this committee, in 1986 to strengthen the Bank frankly haven't helped. The mandate to create an enhanced, marketable Bank guarantee has been thwarted by the Treasury Department.

The war chest created to fight mixed credits has never received a penny of new money, and negotiations to eliminate tied aid credits have produced a diplomatic agreement, yes, but with practical results, none.

It is therefore a welcome development that the Bush Administration is here today to acknowledge that we do have a problem. The problem with mixed credits is just as bad as it has ever been. In fact, it is worse, and we see no let-up. That is the problem, and I am pleased that both of you are here to give us that news. Unfortunately your awareness of it and testimony about it is the extent of the good news. The bad news is that you don't propose to do anything about it.

Extending the War Chest one year and reopening negotiations isn't a plan of action. Japan, France, and others are going to talk, and they are going to talk forever because they know we are never going to back up our words with any action. Why? Because that is exactly how we have behaved in the past.

Mr. Chairman, I think the Banking Committee has to act on this problem and, while we can't give Exim all the money it needs, I think we can give Bank management the tools to maximize the impact of their small program. The bill I introduced some months ago, S. 1217, would give the Bank broader authority to make mixed credit offers, to extend interest subsidies, and to set the terms and conditions of their guarantees without outside interference from the Treasury Department or anybody else.

I admit that that legislation would be not the largest step, but it would be nonetheless a significant step in the direction of the stronger larger Bank we need to compete in key LDC markets, and I urge the committee to think about those changes. I will be urging them in next week's markup.

Thank you very much, Mr. Chairman.

Senator **Sarbanes**. Thank you, Senator Heinz.

Senator Shelby.

Senator **Shelby**. Thank you, Mr. Chairman.

Mr. Chairman, I have a written statement. I would ask unanimous consent it be made part of the record.

Senator **Sarbanes**. It certainly will.

### STATEMENT OF SENATOR RICHARD SHELBY

Senator **Shelby**. Mr. Chairman, I am glad that you scheduled this hearing. I am interested in hearing today's witnesses report on the effectiveness of the "War Chest" or the Tied Aid Credit Fund which is administered by the Exim Bank, with the approval of the Treasury.

Philosophically, I support free trade. I believe that ideally we should have free markets, no barriers and no subsidies. But the truth is that some of our foreign competitors, while paying lip service to this ideal, are using Government assistance to enhance their trade position. These nations have not shouldered the responsibility of setting an example for the rest of the world and consequently are not prevented from aggressively promoting trade while assisting developing nations.

I believe that the War Chest is an excellent vehicle through which this Nation can leverage its trade position. It affords the United States the opportunity to retaliate when necessary against countries that violate or circumvent the spirit of agreements reached through negotiations between United States and OECD countries.

But, it cannot be effective if we do not use it. The War Chest was created in 1986 to respond to congressional concern that existing mechanisms were not working. Yet, last year the War Chest was similarly inactive, using only $7.6 million of the available $110 million.

At the same time, the Exim Bank issues a report that acknowledges the significant cost, of anywhere from $400 million to $4 billion, to U.S. exporters of Tied Aid Credit practices by other countries. This report also acknowledges that U.S. firms have been losing exports in markets traditionally dominated by U.S. firms and that previous agreements between OECD nations and the Exim Bank have not substantially decreased the use of Tied Aid Credits by other countries.

We are now in a global marketplace. We cannot expect U.S. firms to retain dominance in all markets in which our products have been traditionally strong. Clearly, enhanced competition from other nations will result in eroding market share on the basis of price, quality and service, in some markets for some goods. But we cannot cede important foreign markets to international competitors as a result of our unwillingness or inability to effectively challenge foreign government strategy to enhance trade, including subsidy and Tied Aid Credit practices.

For this reason, I feel strongly that the War Chest should be an integral part of trade strategy. At its present funding level, the War Chest is too small to serve as a club against foreign competitors but it should pack more punch than a broomstraw. I look forward to hearing from today's witnesses what we can do to enhance the effectiveness of the War Chest. If necessary, we can make changes so that a year from now, the Exim Bank will not find that U.S. exporters are losing even $400 million in trade to companies from countries with more aggressive government strategies.

The phrase "global marketplace" has already become cliche but it is fact and it will not change. If the United States is to retain economic leadership in this global market, it is necessary now to fight and we must use what weapons we have on hand or create new and better ones.

I want to commend you, Mr. Chairman, for calling this hearing, and I would like to hear from the witnesses and find out why the War Chest was not used, you know, to any great extent. Like Senator Heinz has mentioned, you know, if we are just going to talk and we are going to legislate and execute and perform very little, you know, we are wasting our time, you are wasting your time, and our competitors are gaining the markets day by day, week by week, hour by hour.

I would like to hear what you have got to say later.

Thank you, Mr. Chairman.

Senator SARBANES. Well, on that note, which is not a bad note, we will turn to Mr. Dallara.

Senator BOND. Mr. Chairman?

Senator SARBANES. Oh, I am sorry. I apologize to Senator Bond. I didn't realize you had come into the room.

## OPENING REMARKS OF SENATOR BOND

Senator BOND. Well, thank you, Mr. Chairman, and I appreciate the opportunity to make some remarks.

I am very pleased that we are holding this hearing. I want to associate myself with the remarks of Senator Heinz. Talk is cheap. We haven't been doing the job and to propose that we continue to talk is a rather poor response, I fear, to what is a very significant challenge.

It has become quite clear over the past few years that American businesses have to do a better job of selling in the world marketplace, and it also has become clear that we as representatives working with and dealing with the government must back up American businesses if we are to maintain our position as the world's preeminent economic power.

Businesses are now in the position where they have to look beyond the borders for new markets and new opportunities. Some have been doing this, but many more must join them. Of course, success for many U.S. businesses in the international marketplace, especially smaller businesses, will come much more easily if they can work in partnership with the federal government, which has the resources, the experts and the expertise to track down trade leads and assist with foreign rules and regulations.

The government also has a role to play in ensuring that U.S. firms are not at a disadvantage due to unfair foreign government support for our foreign competitors. Unfortunately, the agencies responsible for performing these functions, including Exim, have not been given the resources necessary properly to perform their roles.

Furthermore, the critical goal of increasing exports has too often been subordinated to other Administration goals. The problem of tied aid has long been a key concern of many U.S. exporters. The United States does not now provide competitive financing to its exports, and there is no question that we suffer because of that. Our failure to compete in the tied aid arena is one aspect of the problem. It is important that we focus attention on it and find ways to alleviate the problem.

Quite clearly, doing a better job in exporting means doing a better job in providing and maintaining jobs in the United States, and that is what we ought to be concerned about.

I look forward to hearing the testimony of the witnesses and to learning from them what they feel is the best way to go about making U.S. companies and, more importantly, U.S. exports competitive throughout the world.

Thank you, Mr. Chairman.

Senator **Sarbanes**. Thank you very much, Senator Bond.

I have a statement from Senator Dixon for insertion in the record.

## STATEMENT OF SENATOR ALAN J. DIXON

Senator **Dixon**. Mr. Chairman, I am pleased to be here this morning as the Senate Banking International Finance Subcommittee conducts an oversight hearing on the Tied Aid Credit War Chest of the Export-Import Bank of the United States. Mr. Macomber, it has not been long since your confirmation hearing; I wish to take this opportunity to congratulate you on your new position and to express my pleasure with having a man of your distinction and experience choose to enter public service in such a vital area. I look forward to your testimony and that of the other witnesses from both the public and private sectors.

In 1986 when Tied Aid Credit War Chest was established, I supported it. I support its reauthorization just as strongly today. I note that the April report of the Eximbank concluded that U.S. exporters lost $400 to $800 million a year in capital goods exports as a result of markets dominated by Tied Aid credits. And I understand others consider these estimates too conservative by a factor of 5. These are shocking amounts.

You know, I am not a supporter of unilateral disarmament—neither militarily nor economically. I want this War Chest, as we call it, of Tied Aid Credits reauthorized. And I want the War Chest redirected. We should use it strategically; we should us it defensively; we should use it efficiently; and, we should use it competitively.

Thank you, Mr. Chairman.

Senator **Sarbanes**. Having taken a careful look at the horizon and now being satisified that we are prepared to go to Mr. Dallara, we would be happy to hear from you.

## STATEMENT OF CHARLES DALLARA, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. **Dallara**. Thank you very much, Mr. Chairman. Perhaps I should delay for one more moment.

Senator **Sarbanes**. Mr. Dallara, let me ask you to suspend for just a moment. [Laughter.]

And before we hear from you we will see whether Senator Graham, who we are very pleased to have join us, has an opening statement he would like to make.

Senator **Graham**. Mr. Chairman, I have no opening statement. I am sorry that my attendance is going to be brief today. I commend you for holding this hearing and look forward to receiving as much information as possible.

Senator **Sarbanes**. Thank you very much.

Mr. Dallara, move quick before the door opens once more.

Mr. **Dallara**. I will do that. [Laughter.]

I have submitted for the record full prepared testimony, Mr. Chairman. With your permission, I would like to ask that that be entered into the record.

Senator **Sarbanes**. Without objection, it will be so included.

Mr. **Dallara**. And this morning I will give you a somewhat abbreviated version of that, hitting the highlights of our position, which as I am sure you are aware is the Bush administration position and not just a Treasury Department position.

### TIED AID CREDITS

I am pleased to be with you and the members of the subcommittee this morning, Mr. Chairman, to discuss the Administration's policies on tied aid credits. My intention today is to focus on the potential role of international negotiations in dealing with the tied aid credit problem and how proposed changes in use of the War Chest and possibly in use of aid monies can support these negotiations.

Let me begin, however, by drawing to your attention some data which have only recently become available.

Tied aid is defined as concessional financing linked to procurement of goods and services in the donor country. Its primary purpose generally is to assist developing economies, and indeed I think it is important that we recognize that much tied aid does just that.

However, we also all recognize that some tied aid clearly has a commercial motivation and it seeks to promote artificially the donor country's exports, especially of capital goods, while at the same time aiding development.

The OECD figures on tied aid credits for the period mid-1987 to mid-1988 showed an increase in total tied aid credit offers. This increase raised questions and concerns as to whether the problem was growing worse despite the fact that only 2½ years ago agreement had been reached which raised the minimum concessionality levels for tied aid from 25 to 30 percent and then subsequently to 35 percent.

The latest data are somewhat more encouraging. These data show a significant decline in total tied aid credits notified, from just over $17.4 billion in the 1987/1988 year to slightly over $14.3 billion in 1988/1989, a drop of just under 20 percent. The decline in credits with concessionality levels of less than 50 percent, one measure of so-called harder aid, which might just be more commercially motivated, although it is difficult to reach a clear conclusion on that, the decline in that type of tied aid was even larger, dropping approximately 25 percent from $14 billion to just under $10.5 billion.

These data are clearly encouraging, but I would hasten to point out that we do not believe we have enough data to tell you that we have an encouraging trend. We hope that will be the case, but we do not as yet really know. Therefore, we continue to rely upon the data compiled, analyzed, and presented in Eximbank's report of earlier this year, which estimates that annual losses of sales by U.S. exporters in the capital goods industries are in the range of $400 million to $800 million.

With that sense of the problem in mind, we have concluded that a new vigorous negotiating strategy is necessary, aimed at reducing the commercial disadvantage U.S. exporters face. This in our view should be the central thrust of the response to the problem as we see it.

As I will point out later, however, it is not in our view just a matter of engaging in discussions or talks. We are prepared to use resources to leverage these negotiations. We will seek aggressively to reduce substantially the trade distortions caused by those practices to the detriment of U.S. exporters.

Groundwork for this effort has been laid over the course of 1989, first at the OECD ministerial, second at the summit in Paris, where we were encouraged to be able to obtain support by other heads of state for language in the communique which expressed strong support for further progress in increasing multilateral discipline over this problem of tied aid credits and urged the OECD to begin work as soon as possible.

Previous negotiations concentrated on raising the minimum required concessionality levels for tied aid credits in order to make them too costly to be used lightly as trade subsidies. That agreement was only fully implemented approximately 15 months ago, I believe. We may be seeing some of the initial encouraging effects in the data that I just cited, Mr. Chairman, and I think it is also true that we have not yet seen its full effect.

Nevertheless, we do agree with many of you that a new effort is required. This new effort in our judgment should not be focused on adjusting further the concessionality level, but rather on other aspects and other directions of attacking the problem.

## POSSIBLE OPTIONS

I have outlined in the prepared testimony a number of possible options that we are actively considering within the Administration and in close collaboration, I might say, with the Eximbank for attacking this problem. Those options include various means of trying to reduce the degree to which tied aid is in fact tied——

Senator **Sarbanes**. Why don't you take a minute or two and set out those options?

Mr. **Dallara**. I will be glad to, Mr. Chairman.

Senator **Sarbanes**. That is very much at the heart of this thing. I know it is in your prepared statement, but I think you ought to just take a moment and lay them out here.

Mr. **Dallara**. Certainly.

The first option—and I would point out at the outset that these are not mutually exclusive options—the first would be to concentrate on effectively untying aid programs for capital projects.

The second would be concentrating on limiting the use of tied aid in particular sectors where we know from experience there are particular problems and, related to that, to focus our efforts on restricting the use of tied aid in markets, some of those developing country markets that Senator Heinz referred to, where we know we have a sizeable problem.

Third, we could concentrate on limiting the use of relatively low concessional aid to a certain proportion of a donor's total program.

Fourth, we could move to require a more open, competitive bidding process for transactions below a certain concessionality level to discourage commercial abuse of low concessional aid.

Fifth, we could move to ban the late introduction of tied aid credits into project bidding.

And sixth, we could move to otherwise improve the guidelines which currently exist to enhance the developmental orientation of tied aid and to move it away from its use as an instrument to gain unfair commercial advantage.

We are in the process within the Administration, under the direction of the Economic Policy Council, of actively reviewing these various options, Mr. Chairman, and indeed it would be most helpful to me, and I am sure to John Macomber, today to hear from you your own thoughts and advice on which aspects of these strategy options appear at first glance to be most potentially productive.

We intend to come up with a tough, carefully developed negotiating strategy which we can take into the first round of new negotiations on this later this fall at the OECD.

Any strategy will have to recognize the fact that U.S. procurement policies also seek to ensure that most foreign assistance funds are spent on U.S. goods and services. Indeed, this is an aspect of the whole problem that we do need to take into account. The orientation of U.S. aid programs has for years moved away from a focus on and intensive use in connection with capital goods.

Nevertheless, all of our food aid and a significant portion, just under half, of our other development assistance is fully or partially tied to U.S. procurement. Of course, this does very little good for the capital goods industry, which is our primary concern here this morning, but it does benefit other important sectors of the U.S. economy, and I think we need to recognize that, as we move forward in trying to reduce the tying of aid, this will inevitably reduce some of the benefits which some of the service industries, such as those in health services, agricultural services, et cetera, receive now from the tying of our bilateral assistance.

I should emphasize that it will not be possible in our view to eliminate completely other countries' use of aid programs to support capital projects, nor do we wish to prohibit fully the use of aid for projects that meet the legitimate developmental needs of recipient countries.

We are, however, after major progress in reducing the scope of this problem, Mr. Chairman, and we are prepared to engage in inevitably difficult negotiations toward this end.

We have carefully considered the question of possible need for new resources. We recognize of course that a case can be made for moving significant additional resources into an effort to attack this problem. On balance, however, it did not appear to us necessary to create a separate tied aid credit program and to commit substantial additional resources at this time.

We share the concerns expressed this morning by you, Mr. Chairman, and by Senator Heinz about the overall state of our trade and current account imbalance. We recognize and welcome of course that there are significant improvements underway in our trade accounts and, in particular, the double digit increase in exports over the last 18 months is encouraging.

Nevertheless, as we work to correct this overall trade imbalance problem, this effort on tied aid credits should be part of the solution.

Current budgetary constraints, in our view, had to be a factor, and we had to recognize that as a practical matter creation of a new tied aid credit program would require an offsetting diversion of funds to the detriment of other programs.

Are we, however, prepared to enter into negotiations without any financial leverage? The answer is no, for I fear that if we did the outcome might be very close to what Senator Heinz and Senator Bond suggest—endless discussions with our allies about a problem that they frankly do not view as as much of a problem as we do.

Therefore, we will not hesitate to commit resources that are available and that we are seeking from Congress as part of the Fiscal Year 1990 budget.

The primary financial underpinning for the previous U.S. negotiating effort was the tied aid credit fund, or the so-called War Chest. Since the conclusion of the 1987 agreement, the War Chest has been used to encourage early and full compliance with the agreement by matching offers from other countries that deviated from its provisions.

In practice—and in response to the question raised earlier by Senator Shelby—there has been little use of the War Chest in recent months, primarily because the bulk of tied aid credits that we have seen have actually conformed to the understandings that were negotiated back in 1986 and 1987.

Nevertheless, it is time we moved to take a more active approach to the War Chest, and we are prepared to use it more actively to support this new round of negotiations.

The Fiscal Year 1990 budget proposals include a War Chest of $100 million. When blended with commercial credits guaranteed by Eximbank, this would allow us to offer nearly $300 million of mixed credit financing at current required concessionality levels. Since not all the offers will be accepted, we anticipate that the Bank could extend an even higher volume of offers.

To the extent that we are able to identify and use foreign assistance funds to supplement Eximbank resources, the volume of funding would be still larger.

### OPTIONS FOR USING THE WAR CHEST

There are three main options for using the War Chest in support of this strategy I am outlining today, Mr. Chairman. Let me just touch on those very briefly, and I will be happy to return to them afterward in questions if you wish.

One option is to target the particular export markets of countries that refuse to cooperate in negotiations.

A second, somewhat more defensive strategy, is to match tied aid offers of other countries where doing so would advance the negotiations, whether or not the countries are being cooperative.

A third option is to take a more activist approach by initiating offers in sectors and markets of particular interest to U.S. exporters where tied aid credits have been used and continue to be used extensively.

At this point our thinking is pointed toward the third of these options, targeting sectors and markets where we have seen in recent years the use of tied aid credits in a heavy volume to provide artificial competitive advantages to foreign exporters.

However, we do not rule out other options, including responding actively to other countries' tied aid credit practices, depending in part on their position in negotiations.

We think a flexible use of the War Chest is needed to send a convincing message of intent to level the tied aid playing field.

Let me add that it was most encouraging in our deliberations at the Cabinet level within the Administration that there is not only a willingness to use the War Chest and available AID funds to help leverage these negotiations, but a willingness, indeed a desire, to consider how we may look for other means of bringing leverage to bear on this problem.

We are actively considering those issues as well, Mr. Chairman, in an effort to elevate the political and economic importance of this issue in our discussions, our meetings, our dialogues with foreign allies.

Where AID or Trade and Development Program funds are available, we would hope and expect those agencies also to undertake joint initiatives with Eximbank to further reinforce the negotiating effort. There are a variety of requirements which would apply to use of AID funds, which I have summarized in my written testimony. Suffice it to say that there are clearly limits imposed both by the very high level of earmarking which currently exists on foreign assistance funds and by the overall thrust of our developmental strategy, but within those constraints we certainly will be looking for ways to use AID funds as part of this effort.

Over the medium term the Administration will consider more fundamentally whether and how U.S. foreign assistance programs might provide greater support for capital projects. This of course is a difficult issue relating to the overall thrust and priorities of our foreign assistance program. We are not here today to engage in an extensive discussion of that, but we recognize that it is an important issue and the Administration is committed to looking carefully at this question.

In conclusion, let me reiterate what Secretary Brady and President Macomber indicated clearly in the letter and report transmitted to you just yesterday, that the Administration is committed to vigorous negotiations to minimize the use of tied aid credits for commercial advantage and to reduce substantially the trade distortions resulting from the current pattern of tied aid credit usage.

In support of these negotiations, we are prepared to use actively the War Chest and available AID and TDP funds in the hopes that we can make major progress in dealing with this difficult problem.

Thank you, Mr. Chairman.

[The complete prepared statement of Charles H. Dallara follows:]

For release on delivery
expected at 10:00 am
September 13, 1989

STATEMENT OF
THE HONORABLE CHARLES H. DALLARA
ASSISTANT SECRETARY OF THE TREASURY
FOR INTERNATIONAL AFFAIRS
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
SEPTEMBER 13, 1989

Mr. Chairman and Members of the Subcommittee:

I am pleased to discuss with you the Administration's policies on tied aid credits. These policies have been developed by the Economic Policy Council in light of a variety of factors including Eximbank's April report to Congress on the tied aid credit practices of other countries.

My intention is to focus today on the potential role of international negotiations in dealing with the tied aid credit problem and how proposed changes in use of the War Chest -- and possibly in our use of aid resources -- can support these negotiations. I would like to begin, however, by drawing your attention to some data that have only recently become available concerning the scope of the tied aid credit problem.

## Magnitude of the Tied Aid Credit Problem

Tied aid is defined as concessional financing linked to procurement of goods and services in the donor country. Its primary purpose generally is to assist developing economies. However, some tied aid also has a commercial motivation in that it seeks to promote artificially the donor country's exports (especially of capital goods) while aiding development. Data collected by the OECD on the tied aid credit programs of member countries do not differentiate between offers which are commercially motivated and those which are not.

OECD figures covering tied aid offers by member countries from mid-1987 to mid-1988 showed an increase in total offers. The increase raised questions as to whether the problem was growing worse despite a March 1987 agreement that raised minimum tied aid concessionality levels from 25 percent to 30 percent in July, 1987 and to 35 percent in July, 1988.

The latest statistics compiled by the OECD for the year from mid-1988 to mid-1989, on the other hand, are somewhat more encouraging. The data, received in late August, show a significant decline in total tied aid credits notified, from just over $17.4 billion in 1987/1988 to slightly over $14.3 billion in 1988/1989 -- a drop of about 18 percent. The drop in credits with concessionality levels of less than 50 percent (one measure of "harder" aid) was larger, from just over $14 billion in 1987-88 to under $10.5 billion in 1988-89. This is a drop of approximately 25 percent. Both these year-on-year comparisons mask an even sharper decline between the last half of 1988 and the first half of 1989.

While encouraging, the latest figures should be treated with caution. Tied aid credit offers remain high by pre-1987 standards. The new data do not necessarily establish a trend, and we do not know with certainty the reason for the decline. Therefore, while welcoming the new figures, we do not as yet consider them a reliable indicator that the tied aid credit problem is on the way to solution.

The Eximbank report to Congress in April made clear that the U.S. tied aid credit problem derives largely from the fact that other countries use their tied aid to support capital projects to a greater degree than we do. Eximbank's report estimated U.S. capital goods exporters lost sales annually of $400-800 million as a result of the tied aid credit practices of other countries. We continue to rely on the Eximbank figures as our estimate of the magnitude of the problem.

## International Negotiations

The Administration has concluded that a vigorous new negotiating effort aimed at reducing the commercial disadvantage U.S. exporters face should be the central thrust of the response to the tied aid credit practices of other countries. We will seek to reduce substantially the trade distortions caused by these practices to the detriment of U.S. exporters.

Groundwork for this effort began at the spring Ministerial meeting of the OECD. The Arche Summit in July lent considerable additional momentum. At the Summit, other G-7 government leaders joined President Bush in expressing strong support for further progress in increasing multilateral discipline over the use of tied aid credits, and urged that the OECD begin work as soon as possible. We intend to use the OECD and Summit guidance as the basis for a major new effort to tackle the problem.

Previous negotiations on this issue concentrated on raising the minimum required concessionality levels for tied aid credits in order to make them too costly to be used lightly as trade subsidies. Since that agreement was fully implemented only a year ago, we probably have not yet seen its full effect. Partly for that reason, and partly because OECD countries are reluctant to accept a further significant increase in concessionality levels at this time, there is agreement here and abroad that a new round of negotiations should focus on some other aspect of the issue than concessionality levels.

A number of alternative negotiating objectives have been suggested in the OECD's export credit and development assistance groups. The major options include (1) effectively untying aid programs for capital projects; (2) limiting the use of tied aid in problem sectors and/or markets; (3) limiting the use of relatively low-concessional aid to a certain proportion of a donor's total program; (4) requiring open competitive bidding for transactions below a certain concessionality level to discourage commercial abuse of low-concessional aid; (5) banning the late introduction of tied aid credits into project bidding; and (6) otherwise improving guidelines to enhance the developmental orientation of tied aid.

It is likely that the U.S. strategy will incorporate more than one of these options, especially since significant portions of the negotiating effort will be focused in the development assistance area. We are assessing which options will offer the greatest scope for success, and will be working in OECD meetings this fall to achieve international consensus on ground rules for the new round of negotiations.

Any U.S. negotiating strategy will have to recognize the fact that U.S. procurement policies also seek to ensure that most foreign assistance funds are spent on U.S. goods and services. Other than food aid (which is all tied), AID estimates that in 1986 about 45 percent of all bilateral loans and grants were fully or partially tied to U.S. procurement, including only about 5 percent for capital projects.

I should reemphasize that it will not be possible to eliminate completely other countries' use of aid programs to support capital projects. Nor does the Administration wish to prohibit the use of aid for projects that meet the legitimate development needs of recipient countries. The negotiating road ahead will be long and difficult, and other countries are not generally enthusiastic about the undertaking. The intermediate goal, reflecting our awareness of the complexity of the task ahead, is to provide a progress report to OECD Ministers at their spring 1990 meeting.

The difficulties notwithstanding, further progress is possible. We can and will work to minimize the effects on U.S. capital goods exporters of the differences in countries' aid policies. Less tying of aid would be of obvious benefit. Intensive work on the problems of "spoiled" markets and sectors also should help. Limiting the share of low-concessional aid may be another promising avenue. The final result should be to focus foreign assistance more on development and less on competitive trade advantage.

## New Resources for a Tied Aid Credit Program

The Administration gave careful consideration to the feasibility and utility of devoting additional resources to a separate tied aid credit program. We recognized that such a program could benefit American exporters whose interests suffer most directly from the tied aid practices of others. It also could advance U.S. negotiating efforts.

On balance, however, it did not appear necessary to create a separate tied aid program and to commit substantial additional resources at this time. Output and employment in the United States are at healthy levels. The nation still is enjoying the longest peacetime economic expansion in the post World War II era. The U.S. trade balance is improving due to better international coordination of economic policies and the revitalization of the domestic economy; we have experienced double digit export expansion over the last eighteen months. Finally, U.S. capital goods exporters tend to be large, well-capitalized, and technically sophisticated.

Current budgetary constraints also were a major factor. As a practical matter, creation of a new tied aid credit program would require an offsetting diversion of funds to the detriment of other essential programs. Such diversion is not justified at this juncture.

## The War Chest

On the other hand, we will not hesitate to commit resources that already are available. The primary financial underpinning for the previous U.S. negotiating effort on tied aid credits was the Tied Aid Credit Fund, or "War Chest." Since the conclusion of the 1987 agreement, the War Chest has been used to encourage early and full compliance with the agreement by matching offers from other countries that deviated from its provisions. In practice, this resulted in little use since most tied aid credits have conformed to the agreement.

The Administration now proposes to use the War Chest actively in support of the new round of negotiations. It also would remain available to ensure implementation of current agreements, should that prove necessary -- though there is no reason to anticipate increased use for this purpose.

The FY 1990 budget proposals include a War Chest of $100 million. When blended with commercial credits guaranteed by Eximbank, this would allow us to offer nearly $300 million of "mixed credit" financing at current required concessionality levels. Since not all of Eximbank's offers are accepted, it would be reasonable for the Bank to extend an even higher volume of offers. To the extent that foreign assistance funds can be used to supplement Eximbank's resources, the volume of funding available for mixed credits would be larger still.

There are three main options for using the War Chest in support of the strategy I am outlining today:

-- Target export markets of countries that refuse to cooperate in negotiations on tied aid, as was done in the past. This would be particularly useful if there is evidence that countries are not adhering to the tied aid credit agreement or that they are blocking cooperative, multilateral solutions to remaining tied aid credit problems.

-- Match tied aid offers of other countries where doing so would advance negotiations, whether or not the other countries are being cooperative. This "defensive" approach can be useful in some cases, but defensive reactions often come too late to give our exporters a real chance of winning the order or to provide much support for a negotiating effort.

-- Take a more activist approach by targetting offers in sectors and markets of interest to U.S. exporters where tied aid credits are used extensively. This approach could have substantial impact for a given expenditure of funds because it allows us to control the timing, location, and size of tied aid credit offers. It would have to be used judiciously, however, in order not to exacerbate the problem.

The Administration prefers to emphasize the third option, targetting sectors and markets of particular interest to U.S. exporters where tied aid is heavily used. However, responding to other countries' tied aid practices may be appropriate in some cases, so matching or overmatching would continue to be options where it serves our negotiating purposes. Such flexible use of a War Chest of the magnitude proposed would send a convincing message of intent to level the tied aid playing field. In addition, we will endeavor to find a variety of ways of augmenting the pressures for prompt, effective action to deal with the trade distortions resulting from tied aid credits.

If negotiations do not proceed seriously and expeditiously, we may be prepared to ask Congress for additional War Chest appropriations in subsequent years. In that case we also would be prepared to reconsider, if necessary, the ways in which War Chest funds are targetted.

## Foreign Assistance Programs

Where AID or TDP funds are available, those agencies will undertake joint initiatives with Eximbank. In such cases, the transaction must (1) contribute to the development of the importing country; (2) satisfy Eximbank's creditworthiness standards; (3) be of potentially long-term benefit to the U.S. economy; and (4) have a significant impact on competitors.

To the extent allowed by its current funding and program authority, AID will begin immediately to maximize support for capital projects. As part of this effort AID, together with TDP, will look for ways to support such projects in cooperation with Eximbank. By exchanging information early in the evaluation phase, the three agencies should be able to identify joint funding opportunities.

TDP's legislative mandate of course allows it to provide direct, tangible support for U.S. capital goods exporters, and some portion of AID's current appropriations can be used to finance the transfer of capital goods as well. However, AID's scope for participation in a tied aid credit initiative is limited by the multiple purposes our aid programs must serve and by the high degree of congressional earmarking. Within these constraints, AID will make available what funds it can.

Over the medium term, the Administration will consider whether and how U.S. foreign assistance programs might provide greater support for capital projects. Provided it is done in ways that meet development standards and the needs of recipient countries, such support would be consistent with the fundamental purpose of U.S. aid programs.

## Conclusions

The Administration recommits itself to vigorous negotiations to minimize the use of tied aid credits for commercial advantage and to reduce substantially the trade distortions resulting from the current pattern of tied aid credit usage.

In support of these negotiations, we propose active use of the War Chest, combined with a commitment on the part of AID and TDP individually and in combination with Eximbank to support developmentally sound capital projects within existing resource constraints. This will not only demonstrate to other countries our continuing concerns about tied aid credit practices, but also will encourage our exporters to maintain a presence in sectors and markets where the use of tied aid credits by other countries is extensive.

Senator **Sarbanes**. Thank you very much, Mr. Dallara.

Now, Mr. Macomber, we would be happy to hear from you, and then we will address questions to both of our official witnesses.

## STATEMENT OF JOHN D. MACOMBER, PRESIDENT AND CHAIRMAN, EXPORT-IMPORT BANK OF THE UNITED STATES, WASHINGTON, DC

Mr. **Macomber**. Thank you very much, Mr. Chairman.

I think it is quite appropriate that my first official session with you after I have been confirmed is dealing with tied aid credits. I have to tell you that I have spent more time on this than I had ever expected in the last few weeks, but I must say it has been time well spent, and I am very optimistic about the outcome of it.

Senator **Sarbanes**. Mr. Macomber, if you could pull that microphone closer to you and speak into it, I think it would help a bit.

Mr. **Macomber**. Is that better?

Senator **Sarbanes**. Yes.

Mr. **Macomber**. Speaking of time, Mr. Chairman, with your permission and in view of Mr. Dallara's very complete review, what I would propose to do is simply highlight the key points, and I would appreciate, though, my full remarks being included in the record.

Senator **Sarbanes**. Without objection, the full statement will be included in the record.

Mr. **Macomber**. As I noted in the confirmation hearings last July, the country is engaged in a very hard fought commercial battle with others over the whole issue of tied aid credits, and today I simply want to reconfirm that view, that it is an absolutely essential problem that needs to be dealt with and we are proposing to deal with it today.

As Mr. Dallara has indicated in a very modest way, the appropriate responses to this problem have been debated very, very seriously and very hard at the highest level of the Administration in the past few months and in particular in the last few weeks, and there is a very brief, hopefully cogent memorandum that we have prepared for you as a summary of where we are.

There are five points upon which we are basing our program.

The first, as Mr. Dallara has said, is that this is an obstacle to the way the economy works. It needs to be dealt with. Let's get at it. That is a very clear-cut point of view that we have.

Second, that we do have to get into the negotiating business and we have to get into it in a very, very serious way. No kidding about it, this has to be a top priority of our negotiators in the OECD. The groundwork had been set last spring. I am very optimistic the negotiations can begin quite soon. It is important that we get them going.

Third, the Bank is going to activate the War Chest, reactivate the War Chest, and make it the centerpiece of everything that we are trying to do in order to get at this problem of tied aid credits, and, Senator Shelby, that is a distinct change. It has been a very dormant program, as I recall, for the last few months, and we are saying that it should be activated in a very strong, robust way, both offensively and defensively.

Now, offensively is different. Offensively is seeking out opportunities where either there is a certain market that is being pilloried or there is a certain category of end-product that is being not fairly represented. That by my definition is an offensive, "let's go get them" type of attitude.

The defensive one is the more traditional approach where clearly there is a violation of an OECD rule. We have always had the right to deal with that problem, but in addition, where there has been a—I would think "blatant" is too strong a word—but where there is an offensive use of aid for the wrong purposes by other countries. This is a change in the way we look at that.

Fourth, over the next few months the Administration is going to be evaluating whether and how we can have a tilt in the basic AID programs so that we can use them more in the direction of capital projects and infrastructure problems. This is a big issue, as you all know much better than I. We are the only country that is in the AID business in a serious way that does not use a substantial part of its AID funds for capital projects and infrastructure projects. We are a lonely fish swimming in a sea of sharks who have an entirely different attitude about AID. It is again an issue that needs to be addressed over the longer term.

But, fifth, in the short term let's use what we have got, and we do have some resources which, if we use our heads and coordinate effectively between the Bank and AID and TDP, we can make a dent in the problem. I don't think it is going to satisfy some people to extent of the numbers, but it is a sensible, reasonable approach.

Before I go on, let me just say there are five points then.

The problem is being taken seriously.

We are going to get at this in negotiations that hopefully will be organized thoughtfully, carefully and we can bring home some bacon.

Third, we are going to use the War Chest aggressively.

Fourth, we are taking a long look at AID.

And, fifth, in the short term we are going to use the resources outside of Exim, either in AID or TDP or where else we can beg, borrow, and steal funds.

Now, in that point, Senator, I think it is appropriate to say that we have a transaction right now that is going through the process which is a wonderful illustration of what we are talking about. We have a situation where Eximbank, AID, and TDP will be cooperating to help a major telecommunications company in this country secure a major piece of business in Indonesia.

Indonesia is one of the more spoiled markets for mixed credits, but Indonesia has, as far as we are concerned, no credit problems with the Eximbank. But on the other hand, it is an area which is misused, or been used as a place to misuse tied aid and mixed aid credits. We are proposing to help this American company secure that business, and we are doing it with a combination of Exim funds and AID funds of a rather substantial amount of money.

It is a wonderful example of how the agencies, if we get our act together, can pull together these different companies to successfully compete. There is no reason, as some of you who I have talked with privately and personally know, there is absolutely no reason why the vast majority of American products are not able to compete overseas now.

Ten years ago we couldn't have made that statement. We have to make that—we can make that statement today because of the vast increases in the level of quality of American products. There is no reason why this telecommunications project cannot succeed, all things being equal.

Mr. Chairman, I think in the interest of time that is a pretty good place to stop, other than to reaffirm our willingness to work with this committee in particular but the Congress in general as we really work hard to make real improvements in the ability of the American business community to compete overseas.

Thank you very much.

[The complete prepared statement John D. Macomber follows:]

# STATEMENT OF
# JOHN D. MACOMBER
PRESIDENT AND CHAIRMAN
EXPORT-IMPORT BANK OF THE UNITED STATES
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
COMMITTEE ON BANKING
UNITED STATES SENATE
WASHINGTON, D.C.
SEPTEMBER 13, 1989

Mr. Chairman and members of the Subcommittee:

It is most appropriate that my first Congressional testimony as President and Chairman of the Export-Import Bank is on Tied Aid Credits. Since my confirmation, no other topic has absorbed more of my time.

As I noted in my confirmation hearing in July, our country is engaged in a hard-fought commercial battle with others over the tied aid credit issue. Today, I reaffirm my view that the Government needs to deal seriously with the problem of mixed credits, and in so doing, help our exporters build our competitive position in foreign markets.

Appropriate responses to this problem have been debated within the highest levels of the U.S. Government over the past several months, and some basic principles have emerged:

First, the Administration considers Tied Aid Credits to present an obstacle to the efficient operation of the U.S. economy, and is committed to addressing the problem.

Second, the Administration concludes that the United States should engage in a vigorous new negotiating effort to eliminate the trade distorting effects of foreign tied aid credits. The ground work for these negotiations was laid this spring at the meeting of the Ministers of Foreign Affairs and Finance of the Organization for Economic Cooperation and Development (OECD), and at the Arche Summit in July 1989. The summit communique contains a mandate for a new and renewed negotiating effort within the OECD framework.

Third, Eximbank plans to reactivate the war chest and make it the centerpiece of our battle plan, pressing our partners to negotiate tighter discipline and eventually eliminate this trade distorting practice.

Eximbank's new war chest strategy represents a marked departure from recent practice. After completion of the March 1987 Tied Aid Credit agreement, the NAC decided that the war chest should be used to police implementation of the new guidelines. Since OECD members moved quickly and fully to comply with the new terms, in the past two years, use of war chest funds was less than $10 million. The Administration has proposed that the war chest be extended at a level of $100 million in FY 1990 both to police the arrangement and to support further negotiations.

We plan to use the war chest both offensively and defensively. We will initiate offers in sectors and markets of particular commercial interest to U.S. exporters where foreign tied aid offers are encountered most extensively. This offensive approach will allow the U.S. to control the timing, location, and the size of our tied aid offers.

The defensive approach will center on matching or "overmatching" other countries' tied aid credit offers which (1) violate the existing OECD agreement or (2) appear to be a blatant use of aid for commercial rather than developmental motives. This approach will demonstrate our willingness to counter, and thwart, other countries' efforts to distort normal commercial trade flows.

By careful allocation of resources, we stand a good chance of convincing others of the seriousness of our intent to eliminate tied aid credits.

Fourth, over the next few months, the Administration will be evaluating whether and how U.S. aid programs might provide greater support for developing countries' infrastructure and capital projects, while, at the same time, significantly neutralizing the trade distorting effects of tied aid. We recognize and must react to the fact that other OECD member countries view tied aid financing of capital projects and capital goods exports as legitimate uses of development assistance.

Fifth, and finally, the U.S. will immediately enlist available AID and TDP funds to provide additional resources for tied aid credits which meet developmental criteria.

We have already identified a transaction which we feel deserves the combined support of Eximbank, AID and TDP--to back American exports for a major telecommunications expansion project in Indonesia. Indonesia, which poses no creditworthiness problems, is, nonetheless, one of the largest recipients of foreign tied aid credits, and therefore it meets Eximbank's targeted market test. Similarly, telecommunications meets our targeted sector test, since U.S. exporters often encounter tied aid competition for foreign telecommunications sales. The project will also make major contributions to the country's development, therefore, AID and TDP participation is appropriate. We will do all that we can to give U.S. firms a fair shot at these orders, and to achieve maximum impact in support of renewed OECD negotiations.

In conclusion, I want to underscore the fact that the Administration considers the use of tied aid credits for trade promotion purposes to be a serious distortion of free trade flows. Other countries, however, have a different perspective, and view the practice as a legitimate form of development assistance. Our objective of eliminating tied aid altogether is not something we can achieve quickly. The process will be long and hard, but we are, nonetheless, committed to the challenge.

I have outlined our initial response to a continuing problem. We will continue to monitor the problem and the progress made. The Administration retains the option of recommending the establishment of an ongoing tied aid credit program in the future if our negotiating proposals are not successful within a reasonable period of time. We also pledge to continue working with the Congress to improve the competitiveness of American exporters and the international environment in which they must compete.

Mr. Chairman, this concludes my testimony. I will be happy to respond to any questions you or members of the Subcommittee may have.

THE SECRETARY OF THE TREASURY
WASHINGTON

September 11, 1989

The Honorable
Dan Quayle
President of the Senate
U.S. Capitol
Washington, D.C. 20510

Dear Mr. President:

In its April 20 report on the tied aid credit practices of other countries mandated by the Omnibus Trade and Competitiveness Act of 1988, the Export-Import Bank indicated that the Administration would be reviewing possible responses to these practices and would forward policy recommendations to Congress. We are pleased to transmit the Administration's recommendations herewith.

Briefly, the Administration recommends that the central thrust of the U.S. response to the tied aid credit problem should be vigorous new negotiations aimed at substantially reducing the commercial disadvantages for American exporters engendered by the tied aid credit practices of other countries. We also recommend that available budgetary resources be used aggressively to support these negotiations.

This approach implies a need to modify the way we use the War Chest as well as to ensure that opportunities for financing capital projects receive increased attention within the constraints of our current aid programs. As a separate though related exercise, the Administration will be considering whether and how U.S. foreign assistance programs might provide greater support for infrastructure and capital projects. Given the other options at our disposal for responding to the problem, as well as current budgetary constraints, the Administration has decided not to seek new resources for a separate tied aid credit program at this time.

The Administration hereby recommits itself to working with the Congress to ensure that, to the maximum possible degree, competition in our export markets focuses on price, quality and service rather than on the availability of concessional financing. Although these negotiations will require perseverance, we expect progress will be made over time that will enable U.S. exporters to compete more effectively. The circumstances underlying congressional concerns will be kept under review, and we are prepared to consider additional action if circumstances so require.

Sincerely,

Nicholas F. Brady
Secretary of the Treasury

John D. Macomber
President and Chairman
Export-Import Bank

THE SECRETARY OF THE TREASURY
WASHINGTON

September 11, 1989

The Honorable Thomas S. Foley
Speaker of the House of Representatives
The Speaker's Rooms
U.S. Capitol
Washington, D.C. 20515

Dear Mr. Speaker:

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Sincerely,

Nicholas F. Brady
Secretary of the Treasury

John D. Macomber
President and Chairman
Export-Import Bank

# REPORT TO THE U.S. CONGRESS ON TIED AID CREDIT PRACTICES

## ADMINISTRATION RECOMMENDATIONS FOR A U.S. RESPONSE

SEPTEMBER 1989

## Introduction and Summary

In April, 1989 the Export-Import Bank forwarded the report to the Congress on the tied aid credit practices of other countries mandated by the Omnibus Trade and Competitiveness Act of 1988. In his transmittal letter, Acting Chairman Ryan observed that the report supported the need for continued, and possibly broadened, U.S. negotiating efforts. He promised that, after reviewing the available options, the Administration would offer its recommendations on how best to support such negotiations and on whether it would be desirable to establish an ongoing tied aid credit program.

On the basis of this review, the Administration has concluded that the U.S. response should center on a vigorous new negotiating effort aimed at reducing the commercial disadvantages for American exporters engendered by the tied aid credit practices of other countries.

The Administration further recommends that available budgetary resources be used aggressively to support the negotiations. Eximbank, the Agency for International Development (AID), the Trade and Development Program (TDP), and other interested agencies are reviewing ways of doing so. We are proposing to modify the way in which we use the War Chest. We also are developing procedures for ensuring that opportunities for financing capital projects receive consideration within the constraints of our current aid programs.

As a separate though related exercise, the Administration will be considering whether and how U.S. foreign assistance programs might provide greater support for infrastructure and capital projects.

Given the other options at our disposal for responding to the problem, as well as our budgetary constraints, the Administration has decided not to seek new resources for a separate tied aid credit program at this time.

## International Negotiations

The Administration reconfirms its commitment to vigorous pursuit of negotiations with our major trading partners, with the aim of achieving further improvements in multilateral discipline over the use of tied aid credits. Our specific objectives are to minimize the trade distortions caused by tied aid practices to the detriment of U.S. exporters and to ensure that tied aid credits serve the legitimate development needs of recipient countries.

The groundwork for further negotiations on tied aid credits was laid at the spring meeting of Ministers of Foreign Affairs and Finance of the Organization for Economic Cooperation and Development (OECD) and at the Arche Summit in July. At the latter, leaders of other G-7 countries joined President Bush in sending a strong signal of support for further progress in this area. They urged that, at the earliest possible date, competent bodies in the OECD pursue and achieve improvements in the present guidelines governing the use of tied aid credits.

A number of possible avenues for negotiation have been suggested in meetings of OECD countries participating in the Arrangement on Guidelines for Officially Supported Export Credits. This is the forum in which the 1987 tied aid credit agreement was negotiated and in which -- along with the OECD's Development Assistance Committee -- the search for multilateral solutions continues. The Administration is assessing various negotiating objectives and strategies with a view to achieving maximum progress toward international agreement on a new negotiating mandate at this autumn's round of OECD meetings.

The principal directions identified so far in which progress might be sought include (1) effectively untying donor countries' aid programs for capital projects; (2) limiting the use of tied aid in problem sectors and/or markets; (3) limiting the use of relatively low-concessional aid to a certain proportion of a donor's total program; (4) requiring open competitive bidding for transactions below a certain concessionality level as a way of precluding commercially motivated aid; (5) banning the late introduction of tied aid credits into project bidding; and (6) otherwise improving guidelines to enhance the developmental orientation of tied aid.

We recognize that it may not be possible to remove all distortions of trade and aid arising from differences in national approaches to development assistance. Nor do we underestimate the difficulty and effort that a new round of negotiations will entail. But we can and will attempt to minimize the scope of such distortions. We expect to provide a progress report on our efforts to OECD Ministers in the spring of 1990.

## The War Chest

Since the March 1987 tied aid credit agreement was reached, the Tied Aid Credit Fund (the "War Chest") has been used to encourage early and full implementation of the agreement by countering offers from other countries that deviate from its provisions. In practical terms this has resulted in few new War Chest transactions, since most tied aid credits conform to the agreement.

The Administration now believes that the War Chest should be used more directly to support our negotiators. In our FY 1990 budget submission, we proposed the extension of the War Chest at the $100 million level to ensure implementation of earlier tied aid credit agreements and to support further negotiations.

When blended with commercial credits guaranteed by the Export-Import Bank, a $100 million War Chest will allow us to offer a total of almost $300 million of "mixed credit" export financing at minimum concessionality levels specified by international agreements. Since not all offers are taken up, it would not be imprudent for the Bank to extend an even higher volume of offers. By using foreign assistance funds from other agencies to supplement the War Chest, the available financing would be larger still.

There are three principal ways of utilizing the War Chest directly in support of international negotiations. One is specifically to target export markets of countries that resist stronger discipline over tied aid credits (i.e., resist further negotiations). This is a course we have followed at times in the past. However, we would be reluctant to recommend such a provocative approach without evidence that countries are not adhering to the tied aid credit agreement or that narrow commercial interests are leading them to block cooperative multilateral solutions to remaining tied aid problems.

A second option is the "defensive" one of matching other countries' tied aid credit offers in cases we judge relevant to our negotiating strategy, whether or not the offering country is resisting negotiations. The defensive approach has been useful because it demonstrates to other countries that the United States is seriously challenging the misuse of tied aid for commercial purposes. Since it is essentially reactive, however, it may bring us into the bidding too late to have a significant impact either on the exporter's chances for winning the order or on the initiating country's tied aid practices.

A third, more activist option is to target offers in sectors and markets of specific commercial interest to U.S. exporters, particularly where tied aid credits are offered extensively. This approach has the potential to have the most impact for a given expenditure of funds, because it allows the United States to control the timing, the location, and the size of tied aid credit offers. It would have to be used judiciously, however, in order not to contribute to an expansion of the tied aid credit problem.

Of these options, the Administration prefers to emphasize the third: targetting the War Chest and other tied aid funds where available in sectors and markets of commercial interest to U.S. exporters where tied aid credits are used extensively. In addition, we propose to use such funds defensively to match or overmatch on a case-by-case basis when it serves our negotiating purposes. Used in this manner, a War Chest of the magnitude proposed would send a convincing message to our trading partners of our firm intent to level the tied aid credit playing field.

Should international negotiations not proceed seriously and expeditiously, the Administration would be willing to review whether the resource levels we have committed are sufficient to address the problem and may be prepared to ask the Congress for additional appropriations in subsequent years. In that case, we also would be prepared to reconsider, if necessary, the ways in which available funds are targetted.

## Foreign Assistance Funds

Within the framework of its existing funding and legislative authority, AID will maximize its support for capital projects. As part of this effort, AID, together with TDP, will look for opportunities to cooperate with Eximbank in project financing, particularly in support of the third option above. Exchanges of information early in the program and project evaluation processes of all three agencies will allow joint financing opportunities to be identified.

In cases where AID and TDP funds are available for joint initiatives with Eximbank, such transactions would be expected to (1) contribute to the development of the importing country, (2) meet Eximbank's creditworthiness standards, (3) be of long-term benefit to the U.S. economy, and (4) have a significant impact on competitors.

While some portion of AID's current appropriations can be used to finance the transfer of U.S. capital goods to developing countries, the scope for doing so is limited by the other purposes our aid programs must serve and by the high degree of congressional earmarking. Within overall budget constraints, however, AID will make available what funds it can under established programs.

In addition, TDP's programs will continue to provide substantial tangible support for U.S. capital goods exporters.

## Focus of U.S. Foreign Assistance Programs

Over the medium term, the Administration will be considering whether and how U.S. foreign assistance programs might provide greater support for infrastructure and capital projects. Although this would be a shift in emphasis compared to our aid programs of the last two decades, there is ample precedent in AID's history for doing so. Such a shift would have to be accomplished in ways consistent with the broad objective of meeting the development needs of recipient countries. We would continue to insist that programs and projects meet development assistance standards and priorities.

## New Resources for a Tied Aid Credit Program

The Administration gave careful consideration to the feasibility and utility of seeking new resources to establish a tied aid credit program. Such a program would be aimed at meeting the developmental needs of recipients, but also would provide more direct support to those of our exporters whose interests suffer most directly from the tied aid credit practices of other countries. It was recognized that a program of this nature could be designed to bolster our negotiating efforts.

On balance, however, the Administration did not find a tied aid credit program of this nature to be of such high national priority as to warrant the expenditure of substantial additional resources at this time. Output and employment in the United States are at healthy levels. Our trade balance is improving as a result of improved international coordination of economic policies and the revitalization of our domestic economy. We also were acutely aware of current budgetary constraints. In these circumstances, the steps we are proposing should be sufficient to accomplish our purposes without the commitment of additional resources required by a new program.

## Conclusion

The Administration will keep under continuing review the magnitude of the tied aid credit problem we face and the progress we are able to make in improving multilateral discipline. We retain the option of recommending that additional resources be devoted to the establishment of a tied aid credit program in the future if sufficient progress is not made toward achieving our negotiating objectives. In evaluating our progress, particular attention will be paid to the willingness of other countries to work with us to limit the scope of trade distortions emanating from their foreign aid programs.

The Administration recommits itself to working with Congress and the U.S. export community to ensure that, to the maximum possible degree, export sales competition is conducted on a basis of price, quality, and service rather than concessional financing. We recognize that perseverance will be necessary if this effort is to produce its intended results, particularly in sectors and markets where tied aid credits are extensively used. We believe the course we have outlined will help otherwise competitive U.S. exporters maintain their presence in those sectors and markets.

Senator **Sarbanes**. Well, thank you, Mr. Macomber, for a very strong and forceful statement.

I guess my reaction is your words say yes, yes, yes, but do your actions say no, no, no, and it is a real question of implementation. The assertions you have made here this morning taken on their face are encouraging in some respects because we haven't used this tied aid credit now for 2 years.

Why not? That is the first question. You got $100 million. You used $10 million of it in each of the last 2 years?

### THE OECD AGREEMENTS

Mr. **Macomber**. This is at the heart—this is one of the—I wish I had a bunch of hearts—this is at one of the main hearts of the issue because there was no legitimate reason that we could use the tied aid—the War Chest in the recent times because it was only used to police the OECD agreements. The OECD agreements have been by and large OK. So the use of the War Chest has been picayune.

But this is a switch now.

Senator **Sarbanes**. But why was it limited to that?

Mr. **Macomber**. As I understand it, that is the way the legislation was.

Senator **Sarbanes**. Is that your view, that the legislation limited you to that purpose only?

Mr. **Dallara**. Mr. Chairman, I would have to go back and review more carefully the legislation, but it is certainly my understanding that the thrust of our War Chest during that time was—first of all, during fiscal 1987, I would point out that exports of $231 million were supported by War Chest grants, and this has trailed off considerably as we have quite frankly observed the initial performance by countries under the most recent agreements.

I would point out, if I may, Mr. Chairman, that we do not sit here today and argue that the full problem will be resolved by the earlier agreements that were reached. Far from it. That is why we are prepared to engage in new negotiations. But at the same time it may well be that we have not yet seen the full positive effects of the earlier negotiations, which increased the concessionality levels required in this whole effort, and we would like to not only actively use the War Chest but observe further the data on use of tied aid credits during the period ahead.

### LEVEL PLAYING FIELD IS REASONABLE

Senator **Sarbanes**. The ultimate objective is to get a level playing field, is that correct? If we can get the other countries to stop doing it or doing it in a way that we regard as reasonable, which we would then do as well, we consider that the ultimate objective, is that correct?

Mr. **Macomber**. Yes, absolutely.

Mr. **Dallara**. That is correct.

Senator **Sarbanes**. How long do you think these OECD negotiations realistically would take to achieve some, if not all of the objectives set out on page 3 of your statement, Charles?

Mr. **Dallara**. Our first goal would be to make progress and then to assess progress by the time of next spring's OECD ministerial. Frankly, I doubt that we will have completed a full round of negotiations by that time. I suspect that will extend on into the full calendar year 1990.

But we certainly intend to push very actively this fall, this winter, and next spring, and then take stock of how much we have accomplished in advance of the next spring's OECD ministerial in Paris.

Senator **Sarbanes**. Well, that gives me the short run outlook, but what is the longer run outlook? How long before you can reach agreements? What is a reasonable period of time?

Mr. **Dallara**. Mr. Chairman, I think it is very difficult to say. I would say that if we have not, however, achieved major progress in these next rounds of negotiations within the next year to year and a half, we then have to reassess whether this approach is working.

I do think that the willingness not only to leverage these negotiations financially but to leverage them in other ways that we may be able to develop within the administration is important, and indeed during our most recent discussions with senior Japanese officials I and others in the U.S. Administration have already taken the opportunity of elevating this issue in our dialog at the highest levels.

Senator **Sarbanes**. I take it from your statement on the use of the War Chest that you are prepared now to use it in a very activist way not as even part of a strategy of getting an agreement but simply to address head on these practices by other countries, so that you would target offers in sectors and markets—and Indonesia is a good example, I take it, because it is both a targeted market and a targeted sector as a matter of fact. So both of those things come together—but you are prepared to target those now to just deal with the competition. Now, they may or may not have an impact on the negotiations. We assume it will have an impact on them, but it is not actually sort of contingent on the negotiating strategy; it is to deal with a situation in which we are at a disadvantage.

Is that correct?

Mr. **Macomber**. Well, I think it is both, if I may say so, because we want to deal with the immediate, but on the other hand, we want to set up enough punch so that the negotiators are in a position to negotiate, and hence the reason to begin the change in the War Chest now and the use of AID and TDP funds now so that as the Treasury gets into these negotiations they have something behind them.

So it is both. It is to help the immediate problem and to build a basis for negotiations.

Senator **Sarbanes**. Now you have indicated you don't want to commit more funds, is that correct?

Mr. **Dallara**. It is correct that at this stage we do not want to commit more funds in that it is already——

Senator **Sarbanes**. And that is on the theory that there aren't more funds to commit, I take it, in part, is that right?

Mr. **Dallara**. Basically.

Senator **Sarbanes**. And I guess your view is, well, we have only been using 10 million, if we start using the full 100 million, that is a ten-time expansion over what we have been doing for two years. Is that correct?

Mr. **Dallara**. Well, not only that, Mr. Chairman, but I would say——

Senator **Sarbanes**. And then the other funds you are going to incorporate in?

Mr. **Dallara** [continuing]. That we are actively looking at the possible use of other funds to help support this effort as well.

It is certainly—if I may return for a moment to your opening statement that part of what you see is yes, yes, yes and part of it says no, no, no. I would like to think that we have taken a strong but measured response to this problem, and as John Macomber said, as we move ahead, and rather actively and quickly, I believe, with the Eximbank, we should not only be able to use these funds to help U.S. industry in particular cases but to send clear signals to our allies as we approach this negotiating round.

Senator **Sarbanes**. Well, now on sending the clear signals—and I know my time has expired. This is the last question I want to put, and then I will defer to my colleagues—I think we ought to give some thought as to what the Congress can do here, since we have to deal with the reauthorization, that helps to send the signal of our continued not only commitment to the program but the deepening of our concern in view of some of these figures and what is developing so that as you are into this negotiating strategy you have the advantage of a strong display of support there.

There is some talk about trying some interest subsidy program for commercial bank loans, enabling your money to go much further. I think we have to be careful how that is done because it is a new departure. You don't know what the ultimate costs are, and you have to be careful about not shifting the risk basically out of the commercial sector.

But the House I know is looking at that approach. Senator Heinz has a proposal in down that path, and I wondered about the views on this possibility of an interest match program of some sort.

Mr. **Dallara**. Well, if I could say a word and perhaps Mr. Macomber would like to add to it, the administration has not yet taken a formal position on this, but we are however actively reviewing it, and I would note a number of things in that connection.

First, it should be recalled that the Reagan administration did indeed at one stage send forward some proposals very much along the lines of what has been proposed by Senator Heinz, some I-match proposals. We are certainly willing to consider this possibility again, but there are perhaps a number of pros and cons in connection with it.

On the positive side, as you yourself mentioned, Mr. Chairman, this could be a very useful way of husbanding scarce resources to leverage our efforts to deal with this problem.

On the other hand, in the past attempts to in effect use the so-called I-match approach have been met by a response by the commercial banks calling for 100 percent guarantee of both interest and principal in connection with the use of the I-match funds. If we were to meet with this response again, this could lead to the guaranteed loans by the Eximbank being scored fully on the budget, which could pose a major problem for us.

So with that background, I would say that we certainly are willing to look at this, but no final judgment has been made.

Senator **Sarbanes**. Do you have thoughts, Mr. Macomber?

Mr. **Macomber**. I would only add, Mr. Chairman, that the House has been working with this for some time and the Bank and others have, as Mr. Dallara said. Conceptually, it makes an enormous amount of sense as a practical way of trying to rekindle the commercial banks' interest in export finance, which at the moment is very, very low. It is one of the highest priorities that I have in my job of trying to help rebuild a bridge between the commercial private banking sector and the overseas export trade area, which at the moment is in a state of deep disrepair.

This is an idea whose time probably has come. Now, the trick is to do it—because it is a tricky thing—is to introduce it in a careful way, and that is why the proposition is to have a pilot of a very modest amount over the next year and see how it works, to find out if some of the negatives that Charles has mentioned are indeed there and, if they are there, if they are not enough to overcome the positives.

So it is a sensible idea whose time probably has come.

Senator **Sarbanes**. Senator Heinz.

Senator **Heinz**. Mr. Chairman, I thought that was a very good question. I am glad you asked it. It saves me asking it. [Laughter.]

### MIXED CREDIT REPORT

I would like to ask Chuck Dallara a question regarding the mixed credit report, and you may have come more or less to the right conclusion but I was a little worried about some of the fine print in the report.

For example, the report indicates that no aggregate trends were identified that U.S. industrial structure has been altered in mixed credit impacted sectors by, for example, decisions to abandon product lines or move sourcing overseas. Yet there has been evidence presented for individual companies or sectors of just such impacts, and to give you one very specific example, that of power generation equipment, where manufacturers in order to match financing offers have suffered lost sales equal to 20 to 50 percent of production capacity.

Now, my question is, are capital sectors being adversely affected or not, and if they are, shouldn't we worry about that, and should the Treasury and the Exim report have come to that conclusion that they weren't?

Mr. **Dallara**. Let me try to give you an initial answer and then if Mr. Macomber has something to add, perhaps he will.

First, I think, as you recognize, I am sure, Senator, this report was the result of quite an extensive survey, quite an extensive effort by Exim, to talk directly with the affected firms and to talk directly with those individuals in firms throughout the capital goods industry who would know the extent of the problem, the specific examples, who would be able to give the specific citations that would enable us to build a base of data from which we could then conduct some analysis.

It is true that of course we found a number of problems, and indeed I think it is fair to say that we would not be here today presenting our proposal to move forward with any——

Senator **Heinz**. Then help me with this. How can you say you found some problems to us—we agree with you, we think there are problems, but how do you square that with what the report says, which was no aggregate trends were identified in U.S. industrial structure that had resulted from this?

Mr. **Dallara**. I would try to square it by indicating that while one can find specific problems with specific firms we did not find a broad-based trend across an industry that would be a sign that there was a serious sectoral problem here, and I think that was a fair, honest assessment of the problem as we saw it.

Senator **Heinz**. All right. Maybe we will hear it from some of our other witnesses on that point.

Let me move on. I, like the Chairman, am delighted that you want to have a War Chest. As you know, the existing War Chest expires the end of this month. The money for any extension of the War Chest, however, is going to come out of the Eximbank's existing authority, is that correct?

Is that correct?

Mr. **Macomber**. Yes, as the legislation is written. Yes, that is right, sir.

Senator **Heinz**. That is our definition of additional resources. [Laughter.]

Mr. **Macomber**. Touché.

Senator **Heinz**. Now, I would like to address this to both of you. What that really means, I gather, is that if you have a $100 million War Chest you are going to have to support it, John, with another $200 million in direct credit.

Mr. **Macomber**. That is right.

### LEVERAGING $100 MILLION

Senator **Heinz**. You know, one-third tied aid, two-thirds direct credit, roughly, and as I subtract that from the $615 million that the administration has requested for fiscal 1990, that leaves about $300 million for the Exim's normal direct credit program. My question is how are you going to operate the direct credit program with so little money?

Mr. **Macomber**. The——

Senator **Heinz**. I have the feeling that you may not have thought about an answer to this question.

Mr. **Macomber**. No, no. The numbers you say are exactly right. Let's assume we use the $100 million and we leverage it up to $200 million through guarantees. That is what I am thinking about. And the guarantee resources up to this point in time have been adequate for us to have enough room to do all this without impinging on the guarantee authority that the Bank has.

You are absolutely correct, though, that we are robbing Peter to pay Paul on the $100 million out of the direct credits. I think it is a mark of the determination that a lot of us have, including Mr. Dallara and myself, to really get at the issue. We are willing to take money out of the direct credit authority, if that is what we have to do, in order to begin to whack at this problem that we are all so concerned about. I wish we didn't have to do it, obviously.

Senator HEINZ. Is——

Senator SARBANES. Could I just interject at that point? I just want to make this observation.

From my perspective, it is better to rob Peter to pay Paul than to rob Paul to pay Peter, if I could just say that. [Laughter.]

Mr. MACOMBER. There is something Byzantine about that remark that may go back.

Senator HEINZ. Thank you, Paul. [Laughter.]

Mr. MACOMBER. May I add, also——

Senator HEINZ. That is on the Chairman's time, I want you to know.

Mr. MACOMBER. I know it. We are still on the Chairman's time.

Senator HEINZ. So it ought to be double.

Mr. MACOMBER. That is also another reason why this I-match which Charles described is—it is a good time to experiment with it.

Senator HEINZ. Is $100 million in the War Chest really enough to do what you want to do, which is to be aggressive, to go into markets and sectors and really raise hell both to support American exporters in markets that are important and sectors that are important and to do what you have to do in markets and sectors that will advance negotiations?

It seems to me you have to do both.

Mr. MACOMBER. That is right.

Senator HEINZ. As I understand what you say you want to do, how can you do it with as little as $100 million?

Mr. MACOMBER. Incidentally, you are absolutely right to underscore the two-pronged nature of this, the short term War Chest, et cetera, negotiations. They obviously tie together.

If we all had our druthers, I would put a lot more money behind it, but stepping back from that, if you take the $100 million, leverage it up to $300 million through guarantees, if we have any luck at all with AID and TDP, I think you can be up to $4-, $5-, $600 million this forthcoming year.

Senator HEINZ. But let's be clear. The guarantees only apply to the export financing, not to the concessional aid?

Mr. MACOMBER. That is true.

Senator HEINZ. The concessional aid is $100 million.

Mr. MACOMBER. No, that is absolutely right. I understand that.

Senator HEINZ. And it is that portion that is fixed.

Mr. MACOMBER. Right.

Senator HEINZ. It is limited. As a practical matter, you are probably not going to be able to pry much away from AID or TDP.

Mr. MACOMBER. We are painfully aware of their limitations.

Senator HEINZ. And so you know you have got $100 million to work with, and that means regardless of whether it is guarantees or direct credits, the total package that you are supporting in the way of export financing is $300 million?

Mr. MACOMBER. That is true, but on the other hand, the way our friendly competitors look at it, it is not necessarily to make a division in the bookkeeping as to how we score it or categorize it. They would look at it in terms of the deal. For example, the telecommunications deal that I talked about, which is probably going to be a 60- to $80-million deal in the short term. Now, there is relatively modest amounts of soft U.S. loan money in that. But they will look at it in terms of the total transaction. Point one.

Point two is while in no way trying to gainsay what you are saying, if we use our heads about targeting countries and targeting specific markets, I think there is a reasonable chance that we can put the negotiators, which is my objective—is to put the negotiators in a position where they have some cards to play with. Clearly, we have to have an inordinate degree of skill and coordination between Treasury, AID, Commerce, TDP, et cetera, to make this work.

But I am not about to set up another government department to do that. If people of good will can do it, we can do it, and we have proved we can do it in the last 2 weeks on this last deal without——

Senator HEINZ. I have one last question if my colleagues will permit me. It has to do with the War Chest.

Mr. Dallara, you said that a year to a year and a half would be your expected negotiating time frame, and I assume that that represents a reasonable time frame. It could take longer. If you are lucky, it could be shorter. Are you asking for a 1 year extension of the War Chest or are you asking for more?

Mr. DALLARA. At this stage, Senator, we are asking for just a year extension. We will of course have to assess the status of our overall negotiations and the possible need for a further extension.

Senator HEINZ. But could you explain why, if you estimate that the negotiations is going to take a year to a year and a half, you would want your principal negotiating leverage to expire during the course of your negotiations?

Mr. DALLARA. Since our negotiations are intended, Senator, to try to really reduce the whole scope of this problem, we don't see the need to signal that we intend to use the War Chest over a period of years to try to leverage it, and we do hope in fact that significant progress can be made within the first year of these negotiations.

### PERMANENT AUTHORIZATION OF THE WAR CHEST

Senator HEINZ. What would be wrong with a multi-year or permanent authorization of the War Chest?

Mr. DALLARA. We just at this stage don't really see the need for it.

And if I could add in response perhaps to your earlier question, I really do believe that we can use the War Chest funds, as limited as they may appear to be in one sense, complemented with the other funds which Mr. Macomber referred to, to launch an aggressive effort here.

Obviously, in one sense the question that you ask is a very pointed one. Are these monies enough? And it is a question that we all have to ask with respect to so many different programs of the U.S. Government. I think it is enough to provide an effective base of leverage for our negotiations, and time will tell whether or not it turns out to be an accurate judgment.

Senator **Sarbanes**. Could I just follow up, if you would indulge me?

Why wouldn't an authorization that at least ran to a realistic estimate of when the negotiations might conclude or even a little bit beyond, be helpful to you in indicating the resolve that exists here on this issue, so that you might have an 18-month authorization here or something of that sort, and of course then you would have to come back to Congress to take another look at this thing.

That still doesn't send the signal that we are going down the permanent path of doing business this way, that our prime objective is still to do away with this and have a level playing field, but it also sends a signal that we really mean business, and the same thing might apply to the authorizing level that is given to the War Chest.

We understand there are problems in funding it, but it would also send the signal in that regard, and I am not quite sure, given your objectives, why either of those and certainly the time period would create any problems, in fact why you wouldn't want it.

Mr. **Dallara**. I think primarily, Mr. Chairman, we just don't see the need for it and it could indeed be seen—if I were to sit here today and say, yes, we need a multi-year authorization—as a bit of a premature judgment on my part in connection with the whole fiscal 1991 budget process which the Administration has to face later this fall. I think we all recognize the tremendous challenge that lies ahead for fiscal 1991 with respect to both authorizations and appropriations, and I just don't think that it is probably my place to sit here and try to perhaps send some premature signals. I really do believe that a one-year authorization will give us a basis to begin. We certainly are not ruling out the possible need for further extension of authorization for the War Chest during the period ahead.

Senator **Sarbanes**. Well, we will have to look at that. I take it from your response your concerns are internal, not external, but from the point of view of external concerns and the basic negotiating strategy, it seems to me you are weakening your posture a bit.

Senator Shelby.

Senator **Shelby**. Thank you, Mr. Chairman.

Mr. Macomber, I know you are very new at the job, but I do like the fact that you stated how much time you are putting in this area as far as the job is concerned.

I am concerned about policy of proactive versus reactive when you are dealing with tied aid. Sometimes I would think that when you are reacting to a situation that you are coming in late, you are—it is going to be hard to make that sell, to make that deal work.

What kind of new policy are you going to pursue as far as proactive?

Go ahead.

Mr. **Macomber**. I think that is—from a practical point of view that is probably the most important single question.

Senator **Shelby**. It is implementation of the whole thing.

Mr. **Macomber**. Exactly, and I cannot guarantee that we are going to make a giant leap forward in this.

Senator SHELBY. Sure.

Mr. MACOMBER. But, Senator, there has been a dramatic shift in the attitude of people that have been involved in this in the last few months because once you get people saying it is important, we can deal with it, it is the correct thing to do, particularly if we have got it tied to a longer term national policy of negotiation, let's figure out simple ways that we can do it. You then begin to go back and suddenly all kinds of simple communication techniques take place.

Senator SHELBY. I hope I am wrong, Mr. Chairman, but history has taught us a lot in dealing with other countries, and our negotiations have been protracted not only in this area, but other areas, but without a hammer there to make the negotiations work I don't believe they are going to work. I think it is going to take a hammer, it is going to take a vigorous use of this tied credit, the War Chest, to make it work.

You know, I have been here 11 years in Congress, and I know we are still negotiating a lot of things, but not much action in our trade policy, and we are being eaten alive.

Mr. MACOMBER. If we don't use this aggressively and actively, Charles is going to have a difficult time negotiating. I would like him to hang around and be a good negotiator. So I want to give him all the ammunition we can.

Senator SHELBY. But we are up against, aren't we, in the real world out there huge companies who not only manufacture but finance, they do everything, and then the government is X, Inc., you know, the whole deal? And you know this from your background in business better than I because you have had to deal with it at the business level.

But I just would like to see the performance and not the negotiations.

Mr. MACOMBER. Yes, sir.

Senator SHELBY. I know you would.

Mr. MACOMBER. Exactly right.

Senator SHELBY. Because I think that will be indicative of whether you succeed or fail in your job, and I believe you are in there to succeed.

Mr. MACOMBER. That is my objective.

Senator SHELBY. One other question. Which OECD nations are the worst offenders in refusing to modify or limit the use of tied aid credit strategies?

Mr. MACOMBER. Would you like to answer that, Charles?

Mr. DALLARA. Well, I think unfortunately——

Mr. MACOMBER. I can't think of who isn't.

Mr. DALLARA [continuing]. A number of the other G-7 countries are right at the top of the list, and I would have to name among them those that continue to provide large amounts of tied aid credits—Italy, the United Kingdom, Japan, and France.

If I could also add, Senator Shelby, to your earlier comments on negotiations, a lot of times when I travel off to international negotiations people wonder why I am carrying such a heavy briefcase. Well, it is not just the briefing material in there. It is the fact that——

Senator SHELBY. You have taken the tied aid with you?

Mr. **Dallara**. No, I take a few——[Laughter.]

I take a few hammers with me, Senator.

Senator **Shelby**. OK.

Mr. **Dallara**. Indeed, the Chairman asked earlier if we could actually not benefit from the posture and the attitude and the actions of the Senate, I would ask that you not only consider what signals you can send and what you can do to back us up in whatever decisions the Senate and the House may make on authorizing and appropriating legislation, but your own personal involvement, your own personal expression of concern when you see leaders of foreign countries or when you write to us, is critical.

I just went to Japan as part of the first round of the so-called structural impediments initiative negotiations with the Japanese, and I can tell you that the flood of mail we received from the Senate and the House in advance of those negotiations was helpful. Quite frankly, some of it had a tone that we may not have been able to put in any Administration correspondence, but it was helpful. We read portions of some of the correspondence to our negotiating colleagues from Japan, and I can only say that as we approach these negotiations with our OECD allies in November we not only welcome your active support through authorizing and appropriations legislation but your public voice on these matters will be important, to know that you are not only seeking to correct the trade imbalance through specific trade legislation, but through strong support for these negotiations. We will need it.

Senator **Shelby**. Isn't it very important that the attitude change here—you got a new chairman—that an attitude that we are going to be proactive, that we are going to back our companies in the world that have products to export, that the people who are buying want our products but can't put it together, you know, because of financing?

A lot of it is an attitude, and when we have money we haven't leveraged—you know, we haven't used, who are we really hurting? We are hurting our own people.

Couldn't you send the word out, Mr. Chairman, Mr. Dallara, that we want to negotiate but if you don't negotiate and you don't have any discipline we are going to back our companies that have products in the world to sell competitively and we are going to play hard ball?

That is what it is about, isn't it?

Mr. **Macomber**. Exactly. Absolutely. Absolutely. I wouldn't change one word of what you just said.

Senator **Shelby**. Mr. Chairman, thank you for your indulgence.

Senator **Sarbanes**. Thank you very much, Senator Shelby.

Senator Bond.

Senator **Bond**. Thank you, Mr. Chairman.

### OUT-CONCESSIONED IN THE CAPITAL GOODS EXPORT MARKET

Gentlemen, I was looking over some testimony given earlier this year by the Chamber of Commerce, and I imagine—I think we will be hearing much the same from the next panel—which was given before a House committee this spring and said essentially that we are getting killed in the capital goods export market, and there they gave some figures. We were discussing the foreign mixed credit offers, and they said from 1984 to 1987 Japan had given $7.9 billion, France $6.4 billion, Germany $5.8 billion, Italy $4.4 billion, and the United States had come in with a grand total of $1.1 billion in that period.

Has the makeup of the credits changed significantly, or are we still being out-concessioned by that magnitude?

Mr. **Dallara**. Senator, I am not aware that the makeup has changed radically. I think those numbers still probably roughly represent the nature of the problem that we face.

Senator **Bond**. My real concern is what has been mentioned, have been brought up in the statements by my colleagues and in the question. My very great concern is where we have any clout in our negotiations with $100 million when we are looking at competitors who are willing to make very significant credit concessions in literally billions of dollars when we are talking about hundreds of millions of dollars.

It seems to me that we were able to get things moving toward an INF treaty when we put Pershing missiles and cruise missiles into Europe. I would hardly think that $100 million is going to be viewed as a Pershing or a cruise missile or anything much larger than a hand grenade when you are talking about mixed credits in the billions of dollars of leverage that other countries are using.

How realistic is the $100 million package?

I would ask either of you to address that. Mr. Macomber.

Mr. **Macomber**. I think it is realistic in direct proportion to the way it is used. It is realistic in direct proportion to the way it is used. If we are targeting key countries—and incidentally, we haven't mentioned this, but the Pacific Basin happens to be the numero uno in terms of our target and the major countries in the Pacific Basin. I am not talking about a vast geographic area as much as I am about India, Thailand, Indonesia—and if we take specific very high profile, big ticket items, that is different than trying to spread a billion dollars all over the world.

Now, clearly the more money you put behind this the more chances of success you have. On the other hand, with the limited resources, it seems to me the thing to do is to target, focus, coordinate, and do everything that we can to give the people who do the negotiations all the cards that they have.

There is no way I can disagree with the basic premise that the more money you have the more chances of success you have.

On the other hand, I have to deal and we all have to deal with the cards that are dealt to us, and I am going to use that War Chest aggressively, selectively. I am going to leverage it up to the maximum extent we can. We are going to do everything we can with TDP and AID, and I am very encouraged despite their budget limitations that we will get something out of it, enough to make it creditable.

Now, we will see.

Mr. **Dallara**. Could I add, Senator Bond?

I think Mr. Macomber really has hit on the right point when he focuses on targeting. If we are not careful, we could engage in, I think, an upward spiral as we try to address this legitimate problem of our export community that may not in the end be effective and only lead to increasing cost and increasing demands on our budget and the budgets of other countries.

A shotgun approach—which I know you are not suggesting—but a shotgun approach sprayed all over the globe is liable to be ineffective. I really think that we have developed, with Mr. Macomber's leadership in the Eximbank, a way of pointing those missiles, so to speak. I think he will be able to make very effective use of the limited number of missiles he has on the right sectors, on the right countries, on the right markets to gain a hold on this problem.

I think that experience suggests that the targeted approach here not only is the most effective, but the most cost effective given the real limitations we have on the funds available and given the apparent willingness of other countries to see more of their budgetary resources drained in pursuit of this problem. Ultimately, we would like to see the problem resolved, as we have indicated, but resolved in the least costly fashion to the taxpayers. I am sure you would agree.

Senator **Bond**. I don't think any of us would disagree with that. We would like to get out of the business of having mixed credits in countries which don't really need direct aid support where it is a genuine commercial transaction.

But you are talking about rifle shot. The same testimony happens to mention a report of the U.S.-China Business Council. Since 1980, foreign countries have offered China $14 billion in mixed credits and the United States has offered $40 million in credits, and it seems like that is pretty good rifle shot right there and we have got a pretty small caliber rifle.

That is the problem that bothers me about it, and obviously we want to get out of it, but our concern here, as you are hearing expressed from everybody, is we are not credible, and what do we need to be credible?

Mr. **Macomber**. I think that is legitimate, very legitimate, and as you know, I have been on the other end of that and have suffered in my previous private life where I have seen other countries use their AID programs to a fare thee well.

In addition to the things that we are talking about today, there is the issue that we have mentioned quietly, which is sooner or later we feel there has to be a good hard look at the way we spend AID funds as a nation over time, and this is a major policy issue that is——

Senator **Bond**. Mr. Macomber, let me follow up on that before the light turns red and ask, given the fact that exports are about 45 percent capital goods, is there any good reason why AID shouldn't be in that capital goods business?

To me—maybe I am missing something, but it seems that we ought to be back in that ballgame. What are the arguments against it? Or maybe Mr. Dallara could address that.

Mr. **Macomber**. Why don't you address that?

Mr. **Dallara**. Let me give it a try. Since AID is not here at the table, I think I should try to offer a few thoughts on what I believe is their perspective.

Basically, for many years the U.S. foreign assistance program has been guided by a number of priorities which have focused on poverty alleviation, development of basic human services, assuring that many of these services, including medical services, are available to the low income peoples in the developing world. This has proven to be—as I look back over the years of the Reagan Administration and looking into the prospects ahead for the Bush Administration—quite frankly a strategy that has received bipartisan support.

We believe there is a legitimate question here as to whether or not additional AID funding should go toward capital goods projects, but I think at the same time it is fair to say that the orientation of U.S. foreign assistance driven towards these concerns and driven by the very high level of earmarking is also legitimate. I think we can't look at the AID budget without recognizing that unless there is less earmarking the flexibility that we have in the Administration to modify the thrust into the markets to which Mr. Macomber referred is very minimal.

Mr. MACOMBER. May I add that the numbers that you quoted from the Chamber of Commerce will be ever thus until there is a shift in policy?

Senator BOND. Thank you, Mr. Chairman. Thank you, gentleman.

Senator SARBANES. Senator Heinz, do you have anything further?

Senator HEINZ. Mr. Chairman, I have just one quick follow-up. I was fascinated with John Macomber's suggestion that if we match $100 million in grants with $200 million of guarantees to achieve the 35 percent grant element and support $300 million in mixed credits without having all of that $300 million count against the direct credit ceiling that we ought to be able to do that with an I-match, where what we are granting is a portion of the interest rate and what we are guaranteeing is the same thing as we would guarantee in a guarantee program; namely, the credit.

So it seems to me if you can do one, you ought to be able to do the other. That is not necessarily a rhetorical question, and your silence will be considered consent. [Laughter.]

Senator SARBANES. Particularly when he is sitting there nodding his head. [Laughter.]

Mr. DALLARA. We are, Senator, going to look closely at this I-match possibility. I think we recognize that there are some good arguments in favor of it.

Senator HEINZ. This means you are going to look.

Mr. DALLARA. It means we are going to look closely at it, Senator. But there are some complications in the previous experience here. As you know, it was not particularly encouraging in light of the reaction of the commercial banks. So perhaps with some skillful approach on the part of Mr. Macomber some greater success could be found if a decision is made to pursue that again.

Thank you.

Senator HEINZ. Mr. Chairman, thank you.

Mr. MACOMBER. There have been, Senator, some very interesting discussions lately that are more encouraging about the practicality of the I-match vis-a-vis the bridge between the Government and the commercial banks. It still needs to be pilot tested. It is too big a thing to go rushing out with. We need to take our time on it.

Senator **Sarbanes**. Well, gentlemen, we could go on at great length. I mean, you have been an excellent panel, and we have another, I am presuming, excellent one to follow.

I had some other questions I could put, but I will withhold them. I do want to say that I think we ought to have discussions over the negotiating strategy at OECD. I am not quite sure why you simply are giving away up front raising the concessionality levels unless that was already done in getting the process underway, but it is not clear to me why part of our objective ought not to be seeking to raise the 35 percent figure to something above that. In any event, it could be a lever to achieving some of these other options, even if not obtainable in itself because of the potential resistance. But if you finally get that figure up high enough, potentially could knock a lot of this stuff out.

I agree with the basic objective of trying to get a level playing field and eliminating these practices. I don't want to see us finally adopt a position where this is an accepted practice and then everyone sets out to do it to the best of their interest. I think that is a breakdown of the trading system rather than an enhancement of the trading system.

So we want to work closely with you in this effort.

Let me make one final comment. I have known Mr. Dallara over the years and have a great deal of respect and regard for him.

Mr. Macomber, I was unable to be at your confirmation hearing because I was chairing a committee hearing elsewhere and had to be there, and I regret that is the case. I want to say, since you said in your statement this is your first testimony on the Hill, that it was very impressive. We really expect great things from you at the head of the Export-Import Bank, and you bring an experience and record that reflects a competence which was reflected at the witness table here today. You have obviously been a man who has also been concerned about public service over his career, and I am glad we now have you aboard full time, and we wish you well and we look forward to working very closely with you in the months and years ahead. I think that you can give an impetus and a force and a thrust to all of these efforts that is extremely important.

So not having been at your hearing and in a position to make that comment, I want to make it here this morning, particularly after you have had your first session at the witness table.

Thank you very much for coming and being with us.

Mr. **Macomber**. Thank you.

Senator **Sarbanes**. If the next panel would come forward, we would be happy to hear from them.

We are very pleased to have this panel, and we will move right into it. Unless you all have worked out an order amongst yourselves that you think makes sense, I think I will start with Mr. Armenian and come across to Mr. Kittredge and then conclude with Mr. Tucker.

Mr. Armenian, we would be very pleased to hear from you, sir.

## STATEMENT OF GARABED K. ARMENIAN, DIRECTOR OF GOVERNMENT FINANCE, WESTINGHOUSE ELECTRIC CORP., WASHINGTON, DC, ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS AND THE COALITION FOR EMPLOYMENT THROUGH EXPORTS

Mr. **Armenian**. Thank you, Mr. Chairman.

I have a fuller testimony which has been submitted, and I would appreciate it if that——

Senator **Sarbanes**. The prepared statement will be included in the record, and it is a very carefully done statement and we appreciate that very much.

Mr. **Armenian**. Thank you, sir.

Mr. Chairman, my name is Garabed Armenian, known as Garo Armenian, Director of Government Finance for Westinghouse Electric Corporation. I am here today on behalf of the Coalition for Employment Through Exports and the National Association of Manufacturers.

### MIXED CREDITS OR TIED AID

We appreciate this opportunity to discuss the subject of mixed credits or tied aid.

Mr. Chairman, America trades today in an international market inhabited by competitors who are not necessarily free market oriented. Our foreign competitors aggressively use their foreign assistance programs as well as their political resources to promote their export business. This is an age old policy cast in business tradition that cannot change easily.

In particular, this decade has witnessed the widespread use of mixed credits, and mixed credits have been used as a device to create unfair preference in a highly competitive market, a device perfected mainly in Europe and in Japan.

From the beginning, Mr. Chairman, the United States Government viewed this practice as a threat to the international marketplace, but the staying power of foreign mixed credits was underestimated. The U.S. Government favored a negotiated solution, and here we have overestimated our powers of persuasion, since so far the U.S. position has failed to keep this phenomenon in check.

Mr. Chairman, as exporters we have learned that negotiations to eliminate foreign export subsidies in the form of mixed credits cannot produce acceptable results unless the U.S. is willing to compete with like resources. The U.S. exporters, large and small, cannot effectively compete in this distorted market without the U.S. Government policy which would equalize the playing field.

This market was distorted by powerful governments, Mr. Chairman, and it needs a decisive and fair-minded government to take the lead to restore the order and its workings. We think that the U.S. Government should provide that leadership to adequately support—to provide adequate support to U.S. exports.

Here I would like to emphasize that U.S. exporters are not seeking to create competitive advantage based on U.S. Government-supported financing, as was mentioned in the memorandum from which you quoted, the Administration's memorandum. The U.S. exporting community does not need an advantage of that sort. The

U.S. exporters will aggressively compete on the basis of price, technology, product quality, service and delivery, and maintain their market share. However, the U.S. exporters will be unable to compete on such commercial terms if they are kept at competitive disadvantage by the generous tied aid credits offered by other nations.

Stated differently, Mr. Chairman, the status quo in export finance is unfair and intolerable for the United States. It must change, and here it must change by a significant margin. A determined export finance policy must be established which indicates that we intend to prevent an unfair erosion of the U.S. competitive position in the export markets, a policy that recognizes the U.S. exports as a valuable national resource which cannot be wasted or abandoned, a resource which needs to be defended with adequate tools, and the tools of the private sector in this case can only do part of the job since the challenge now comes from enormously powerful governments.

Mr. Chairman, CEE and NAM would like to note that the study released in April by Eximbank on tied aid credits while impressive, did not fully respond to the Congressional request. As you know, the administration was rightfully criticized in Congress for not providing recommendations in the above-mentioned report.

The administration spokesman suggested that more time was needed then for a fuller deliberation by the cognizant agencies. The administration did pursue this matter within the Economic Policy Council, as was mentioned here. It is now September 13, Mr. Chairman. An entire fiscal year has practically elapsed, during which the U.S. exporting community has had to face severe predatory competition, yet without a clear solution in sight.

Mr. Chairman, we are encouraged this morning by Mr. Macomber's understanding of this critical issue and his commitment to pursue efforts that would make a difference on this front. His words were incisive and clear. I was particularly impressed by the word "robust" in his testimony.

The question now is whether the steps initiated or to be initiated by the administration will be credible enough to address the problems faced by the business sector now and not many, many years hence.

## RECOMMENDING FULL-FLEDGED TIED AID CREDIT PROGRAM

Mr. Macomber's testimony indicates that the administration still retains the option for recommending a full-fledged tied aid credit program if negotiations do not produce results within a reasonable period of time.

Mr. Chairman, we do not have the luxury of time any more to solve this problem solely through protracted negotiations within OECD.

As was rightfully suggested, the battle against foreign tied aid will be a hard one, requiring substantive measures. In this regard, Westinghouse has extensive experience in many product categories and, more particularly, in power generation equipment and electronic systems. Our facilities are located in your own State, in Pennsylvania, in Florida, and in many other States. During the last 9 months, Westinghouse has encountered extremely difficult mixed credit confrontations in Mexico, Morocco, Tunisia, Zimbabwe, Colombia, China and elsewhere. In every case the competition has offered financing packages with grant elements of 35 to 40 percent.

Other member firms of CEE and NAM have similar situations to report.

Mr. Chairman, we cannot afford to lose these orders when negotiations are taking place. These are valuable one-time market building opportunities which would seal market shares for Westinghouse and other U.S. firms.

In our view, the tied aid credit problem is much bigger than the capabilities of any single agency of the U.S. Government, including Eximbank. The solutions to this problem have to come from the combined interagency capabilities of the U.S. Government and, more specifically, from the coördinated efforts of Eximbank, the Agency for International Development, and the Trade and Development Program.

We are gratified by the fact that this is now part of the administration's recommendations.

In this regard, we are pleased to offer some initial steps which can begin to address the problem.

No. 1, to make sure that the basic component of a mixed credit package is adequately available, as Senator Heinz suggested, a renewed commitment is necessary for Eximbank's direct lending program.

In this regard, we wish to thank you, Mr. Chairman, Senator Riegle as Chairman of the full committee, Senators Garn and Heinz and other members for recognizing over many years the importance of the direct loan program and, more recently, in your own correspondence to the OMB Director Darman earlier this year.

No. 2, the statutory purpose of Eximbank's current War Chest is to encourage the competing nations to solve this problem through OECD negotiations. As I said earlier, these negotiations did produce an agreement, yet they failed to produce the expected results.

The War Chest should therefore be freed from any negotiation-related inhibitions.

No. 3, To bring meaningful additionality to ExIm Bank's loan and guarantee programs, as well as its War Chest, the U.S. Foreign Assistance Program should be imaginatively employed to increase the U.S. strategic response capability in the export field. We see that this too is now adopted by the administration, at least in principle. We would like to see the administration take quick and decisive steps in this field.

## EXTENSIVE REINVOLVEMENT BY THE U.S. AGENCY FOR DEVELOPMENT

We consider imperative an extensive reinvolvement by the U.S. Agency for international development in capital projects, combining the developmental interests of the recipient countries with the U.S. commercial interests.

In summary, Mr. Chairman, the administration is not recommending new funding for this new thrust. What we see the administration recommending is a redefined leverage, bringing the interagency capabilities of the U.S. Government.

Here, we have three issues that need to be considered. No. 1, it is important that that effort be vigorous. No. 2, it is important to establish a process to make that effort possible and timely. Therefore, it is very important to identify the agency responsible that will bring the pieces together. No. 3, it is also important to determine what is a reasonable period of time and also the responsibility that would define that reasonable period.

Mr. Chairman, this concludes my testimony on behalf of CEE and NAM. I appreciate this opportunity to appear before the subcommittee today, and would be pleased to answer any questions. Thank you.

[The complete prepared statement of Garabed K. Armenian follows:]

**Coalition for**
**Employment Through**
**Exports, Inc.**

USA EXPORT

NAM
National Association
of Manufacturers

PREPARED STATEMENT

of

Garabed K. Armenian

Director, Government Finance

Westinghouse Electric Corporation

on behalf of

The Coalition for Employment

Through Exports, Inc. (CEE)

and

The National Association of Manufacturers (NAM)

before the

Subcommittee on International

Finance and Monetary Policy

Committee on Banking, Housing and Urban Affairs

U. S. Senate

Washington, DC

September 13, 1989

Testimony of Garabed K. Armenian
Director, Government Finance
Westinghouse Electric Corporation
before the
Senate Banking Subcommittee on International
Finance and Monetary Policy
September 13, 1989

Good morning Mr. Chairman and members of the Subcommittee. My name is Garabed (Garo) Armenian, Director of Government Finance for Westinghouse Electric Corporation. I am here today on behalf of the Coalition for Employment through Exports (CEE) and the National Association of Manufacturers (NAM).

We appreciate this opportunity to discuss the subject of mixed credits or tied aid. In particular, we wish to focus on the recent EXIMBANK Report to the U. S. Congress on Tied Aid Credit Practices and ongoing Administration discussions of this problem in the Economic Policy Council (EPC). In addition we would like to offer some policy options which we would request the Subcommittee to consider.

## Trade and Aid

America trades today in an international market inhabited by competitors who are not necessarily free-market oriented when it comes to exports. Our foreign competitors aggressively use their foreign assistance programs, as well as their political resources, to promote their export interests. This is an age-old policy cast in business tradition that cannot change easily. In particular, this decade has witnessed the widespread development of the most predatory form of export financing practice - the mixed credit. Mixed credits have been used as a device to create unfair preference in a highly competitive market; a device perfected mainly in Europe and in Japan. From the beginning, the United States government viewed this practice as a threat to the international marketplace, but the staying power of foreign mixed credits was underestimated. As a result, rather than combat these credits with competitive programs which would serve to guard our market share, the U. S. government favored a negotiated solution to rid the arena of this type of financing. And here, we have overestimated our powers of persuasion, since, so far, the U. S. position has failed to keep this phenomenon in check.

In point of fact, our experience over the last few years has shown time and again that the OECD agreement on mixed credits has not deterred our trading competitors from using mixed credits. On the contrary, as stated in the Eximbank Report, almost 70% of government-supported export financing offers - $15 billion - are in the form of mixed credits. The U. S. efforts at wanting to make the practice expensive and thus discourage the appetite for this type of financing, have only served to institutionalize our disadvantage. Mr. Chairman, as exporters, we have learned that negotiations to eliminate foreign export subsidies (in the form of mixed credits) combined with a policy which fails to compete with

like resources, only deny the U. S. a truly competitive position in the market. The U. S. exporters, large and small, cannot effectively compete in this distorted market without a U. S. government policy which would genuinely equalize the playing field by comparable support. This market was distorted by powerful governments, Mr. Chairman, and it needs a decisive and fair-minded government to take the lead to restore the order in its workings. We think that the U. S. government should provide that leadership by adequate support to
U. S. exports. And such support must be available and applied on a consistent and sustained basis. We were clearly encouraged by a statement by EXIMBANK Chairman John Macomber during his recent nomination hearing. When asked about the tied aid issue, Mr. Macomber responded that though the Government must continue to seek negotiations to end the practice, the U. S. can no longer have a singular policy out of step with the world.

Mr. Chairman, while our competitors take steps to strengthen their respective export financing capabilities, the U. S. continues to retain its own system which is generally marked by limited measures, fragmented institutional responsibility and severe underfunding. In the mixed credit area, a steady expansion of this practice has served to position our competitors in key markets of the Third World.

Mr. Chairman, I emphasize this point by reviewing the following figures (taken from an article written by Ambassador Ernest Preeg; a copy of the article is attached) which represented the percent of bilateral foreign aid going to capital goods projects by major donor nations:

| | |
|---|---|
| Japan | 45.8% |
| Demmark | 33.0% |
| Norway | 22.5% |
| Germany | 20.8% |
| Italy | 17.0% |
| United Kingdom | 15.4% |
| Canada | 14.0% |
| Sweden | 13.3% |
| France | 13.0% |
| United States | 2.3% |

The dramatically different orientation of the foreign assistance programs of other exporting nations has kept the U. S. exporters out of important development sectors in the Third World, and has had a serious adverse impact on the U. S. trade deficit.

Mr. Chairman, CEE and NAM believe that the evidence is clear that the continued expansion of reported mixed credit offers show conclusively that a policy which limits the U. S. response to limited defensive retaliation and international negotiations is counter-productive. Eximbank's "war chest" program embodies this limitation . There must be a viable and cost-effective approach which allows the U. S. exporter a comparable competitive position. The U. S. exporters are not seeking to create comparative advantage based on U. S. government-supported financing packages. The U. S. exporting community does not need such advantage. The U. S. exporters will aggressively compete on the basis of price, technology, product quality, service and delivery and maintain their market share. However, the U. S. exporters will be unable to compete on such commercial terms, if they are kept at competitive disadvantage created by the generous tied aid credits offered by other nations. Stated differently, Mr. Chairman, the status quo in export finance is unfair and intolerable for the U. S. It must change, and change by a significant margin; we think the U. S. government must change it, otherwise the status quo will invite a permanent weakening of the U. S. export position.

A determined export policy must be established which indicates that we intend to prevent an unfair erosion of the U. S. competitive position in the export markets; a policy that recognizes the U. S. exports as a valuable national resource which cannot be wasted or abandoned; a resource which needs to be defended with adequate tools. The tools of the private sector, in this case, can only do part of the job, since the challenge now comes from enormously powerful governments.

## The Tied Aid Practices Study

Mr. Chairman, CEE and NAM would like to note that the study released in April of this year by EXIMBANK on tied aid credit practices, while impressive, did not fully respond to the congressional request. It is a study which provides some very useful information.

The Administration was rightfully criticized in Congress for not providing recommendations in the above mentioned report as required by the Trade Act of 1988 and due last December. The Administration spokesmen suggested, in their response, that the Executive Branch needed more time to have a fuller deliberation on this issue before any meaningful recommendations would be formulated reflecting the views of the cognizant agencies.

The Administration did pursue this matter within the Economic Policy Council. It is now September 13th; an entire fiscal year has practically elapsed during which the U. S. exporting community has had to face severe predatory competition based on foreign tied aid, yet without a clear solution in sight.

Mr Chairman, we are encouraged by Chairman Macomber's understanding of this critical issue and his commitment to pursue efforts that would make a difference on this front. Yet we need to emphasize that currently there exists a massive gap in U. S. trade policy which the Administration must address. The question is whether the Administration's future plans will, in fact, reflect the true priorities of the U. S. exporting sector. The question also is whether a set of useful steps will be initiated by the Administration which would address the problems faced by the business sector now and not many years hence. Mr. Chairman, we do not have the luxury of time any more to solve this problem solely through protracted negotiations within OECD, especially when we have proved over the years that we are in such a weak negotiating position.

This concern is reinforced by the fact that the Report does not do justice to the true picture of the tied aid credit problem. In our view, the Report underestimates the impact of this problem and understates its magnitude. We think that the data clearly reveals a massive and growing exposure for the U. S. which, in our view, should have been articulated with a greater sense of urgency. Throughout the study process, many of our companies were consulted and briefed on the progress of the Report. We think that the data collected by the Bank on the current state of tied aid credits should have led the Bank to identify the crisis proportions of this problem.

Unfortunately, the final Report, Mr. Chairman, makes no such statements. In our view, the study should have concluded (based on the very data of the report) that the actual loss by the U. S. of capital goods exports is not the estimated $400-$800 million, as suggested in the conclusions of the Report, but rather in the range of $2.4-$4.8 billion. This is quite a disparity and certainly more significant in its ultimate impact.

Mr. Chairman, we think the Subcommittee should be guided by the serious strategic implications of the mixed credit competition. Europeans and Japanese resort to mixed credit financing in order to position their export industries strategically in key export markets. Mixed credits insure foothold; they insure strong alliances going far beyond the immediate dollar value of exports financed. In most cases, these are one-time opportunities and the next time is already too late. The Report acknowledges that this is a concern, but it fails to recognize its crucial importance.

The Report also concludes that, on the macro level, no noticeable impact on market share or industrial structure can be found. In our view, this statement is misleading. Mixed credits, in themselves, are not a macro-economic problem; a mixed credit package is a micro-economic tool; it is a lever; a lever, by definition, is a small implement by which large magnitudes are displaced. A mixed credit can be insignificant in the large macro-economic magnitudes, but it can - and it does - cause permanent damage to the U. S. economy in places where it matters, such as the structure of U. S. industry and U. S. domestic employment.

As to the Policy recommendations, a divided camp seems to exist in the Administration. Reportedly, this division is between those who genuinely acknowledge the problem and seek immediate policies to address our export hemorrage and those who feel that a substantive policy response by the U. S. would exacerbate our constrained budget picture.

Mr. Chairman, what the U. S. exporters need is a fair balance between these priorities. As we said before, a very valuable national resource is at issue here; a resource that needs to be protected, not abandoned. Providing credible response to the foreign tied aid practices is a vital investment the U. S. needs to make. Not providing such support is tantamount to being wasteful and surrendering an important element of our economic vitality.

If, in fact, there exists a divided camp within the Administration, as U. S. taxpayers, we are on the side of those who are willing to be decisive in this matter.

At a minimum, the Eximbank's current war chest program should be made more flexible by removing the various conditions-of-use requirements which are either no longer applicable or unnecessarily restrictive. The current language ties the program to the purpose of "facilitating the negotiation of a comprehensive international arrangement restricting the use...for commercial purposes." This purpose has been accomplished though the product is far from being satisfactory. In addition, and in tandem with the negotiation purpose, the current program is required to be administered "in consultation with the Secretary of the Treasury and in accordance with the Secretary's recommendations ... to promote the negotiation and, ... in consultation with the National Advisory Council on International Monetary & Financial Policies". These requirements are a hindrance and no longer necessary to the aforementioned negotiation policy. Lastly, the program operates strictly in a response mode to a violation of the current OECD agreement. Mr. Chairman, we are losing the battle while the U. S. is policing the international agreement on mixed credits, therefore we need a program which can also aggressively target key projects and markets where unfair competition exists.

The U. S. exporters would prefer the establishment of a Mixed Credit Program which operates at the Bank's discretion to combat this type of predatory financing in an offensive or defensive manner based on the merits of each project. We feel this simpler structure will allow the Bank to operate the program with a greater degree of flexibility and with an ability to adjust to current market conditions and strategic interests. We feel the Bank is capable of doing this without the intervention of U. S. Treasury and the NAC.

## Examples of Business Losses

Mr. Chairman, Westinghouse has extensive experience in this field in many product categories and, more particularly, in power generation equipment and electronic systems. A recent survey of our export marketing efforts in the field of air traffic control equipment reveals a chronic incidence of this phenomenon. During the last nine months, Westinghouse has encountered extremely difficult mixed credit confrontations in Mexico, Morocco, Tunisia, Zimbabwe, Colombia, China and elsewhere. In every case, the competition has offered financing packages with grant elements of 35-40%. With its own limited means, Eximbank has struggled hard to assist in our efforts; we have also obtained some limited support from U. S. AID and Trade and Development Program. These, however, are the rare exceptions to the rule. The fact of the matter is that we may end up losing many of these orders or may have to resort to foreign sourcing at the expense of U. S. labor.

These are valuable one-time market-building opportunities which would seal market shares for Westinghouse for extended periods.

## Policy Recommendations

Mr Chairman, the tied aid credit problem is much bigger than the capabilities of any single agency of the U. S. government; it is definitely much larger than the budgetary latitudes of Eximbank wherein our current war chest program exists. The solutions to this problem have to come from the combined inter-agency capabilities of the Administration, and more specifically, from the coordinated efforts of Eximbank, the Agency for International Development, and the Trade & Development Program.

In this regard, we are pleased to offer some initial steps which can begin to address the problem:

a) To make sure that the basic component of a mixed credit package is adequately available, a renewed commitment is necessary for Eximbank's direct lending program. Eximbank direct credits are the mainstay of any tied aid credit package supplying the non-concessionary portion of the financing required.

   In this regard, we wish to thank you, Mr. Chairman, Senator Riegle as Chairman of the full Committee, Senators Garn and Heinz, and other members for recognizing, over many years, the importance of the direct loan program, and more recently, in your correspondence to the OMB Director Darman earlier this year.

b) The statutory purpose of Eximbank's current war chest is to encourage the competing nations to solve this problem through OECD negotiations. As I said earlier, these negotiations did produce an agreement, yet they failed to produce the expected results. We believe the purpose of the war chest statute must be broadened to indicate the U. S. willingness to bring a fundamental solution to this problem.

In this regard, we encourage the committee to respond with legislation which would lend flexibility to a mixed credit program as mentioned earlier in my testimony. We would be glad to work with the Committee and its staff to develop this type of legislation on a timely basis.

c) To bring meaningful additionality to Eximbank's loan and guarantee programs, as well as its war chest, the U. S. foreign assistance programs should be imaginatively employed to increase the U. S. strategic response capability in the export field.

In this field, we consider imperative an extensive reinvolvement by the U. S. Agency for International Development in capital projects in AID-assisted countries, combining the developmental interests of the recipient countries with the U. S. commercial interest.

Mr. Chairman, this concludes my testimony. On behalf of CEE and NAM, I appreciate this opportunity to appear before the Subcommittee today and I would be pleased to answer any questions.

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# Trade, Aid, and Capital Projects

*Ernest H. Preeg*

A MAJOR CRITICISM of the U.S. foreign assistance program—economic aid to developing countries—is that it does not support U.S. export interests as other donor countries, such as Canada, Japan, and those in Western Europe do. At a time of huge and unsustainable trade deficits, this is one more example of how the United States puts other international objectives ahead of its trade interests, contributing further to the decline of its own power and influence in the global economy.

This charge is largely true in one key area of trade-aid relations, namely in high-technology, capital-intensive industries. However, the circumstances for the current predicament and, more important, the feasible options available to the United States to do something about it are poorly understood. Figures on tied versus untied aid can be misleading, and statements as to what other donors actually do tell only part of the story. Several actions taken by the United States in recent years have, in fact, addressed only part of the problem. The result, at best, is but a glancing blow to the difficulties faced by U.S. exporters.

A basic conceptual problem is the cleavage in thinking between those people concerned with commercial interests and those with economic development objectives, although in certain important areas, trade and aid interests are inextricably linked. Moreover, this cleavage passes from people to institutions, both in the mandates of executive branch agencies and in congressional committee jurisdictions. In short, the trade-aid relationship has been slipping between the cracks in terms of a coherent policy response, to the detriment of U.S. export interests as well as of the most efficient delivery of foreign economic assistance. To address the situation, the stakes must be clarified and suggestions be made for restructuring U.S. foreign economic assistance and related export finance programs. A more fruitful balance between U.S. trade and development interests must be found.

## Current U.S. Aid

U.S. bilateral economic aid to developing countries since the 1960s has been concentrated on direct assistance to the poorest segments of the population, for "basic human needs." Projects abound in rural health delivery systems, population, primary education, small-scale agriculture, labor-intensive construction of secondary roads, and community development. During the 1980s U.S. economic aid has focused, in addition, on fast disbursing balance-of-payments assis-

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Ernest H. Preeg is a senior fellow at CSIS. He was chief economist of the U.S. Agency for International Development from 1986 to June 1988.

tance, in large part contingent on market-oriented policy reforms undertaken by the recipient government. Food aid assistance, under PL—480, has supported both of these objectives. The United States supplies grant food aid directly to the most needy, such as in maternal and school-feeding programs. Commodity food provided to recipient governments constitutes fast disbursing balance-of-payments support (often linked to policy reform), and local currency generated from the sale of the food is earmarked for programs to strengthen indigenous food supply. U.S. bilateral economic assistance in recent years totals $8.5 to 9 billion: about $4 billion in fast disbursing balance-of-payments support, $2.5 billion in basic human needs projects, $1 to 1.5 billion in food aid, and $1.5 billion in such other categories as disaster relief, support for the private sector, and a few large infrastructure projects.

The relationship between this bilateral economic assistance program and U.S. export interests is, for the most part, difficult to quantify. The only clearly linked portion is food aid, where the assistance consists of in-kind shipment of U.S. surplus farm products. Internationally established procedures try to assure that food aid constitutes exports other than what developing countries would have purchased in commercial markets. Before the United States commits itself to food aid, it consults with other major food exporters about the "usual marketing requirements," which relate the proposed food aid to the commercial import level in previous years and foreign-exchange constraints on food imports.

Much of the remainder of U.S. bilateral economic aid is tied to U.S. exports, in that the aid project specifies procurement of U.S. goods and services. In 1986 the United States reported to the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) that about 45 percent of bilateral assistance, not counting food aid, was either fully or partially tied to U.S. procurement. These figures, however, are shaky estimates and overstate the degree of U.S. procurement. The U.S. Agency for International Development (USAID) operates on a highly decentralized basis, delegating considerable authority to field missions. This approach is sound for delivering economic assistance, particularly for management-intensive, basic-human-needs projects. However, as a result, detailed information on procurement is not available in Washington, and figures reported to the DAC are estimates based on a survey undertaken several years ago. Moreover, these estimates do not account for those portions of a tied project used for local procurement rather than imported goods and services. It also does not account for discretionary authority USAID mission directors have to waive U.S. procurement when it is not feasible or extremely expensive. For example, rural projects in sub-Saharan Africa often include significant funding for vehicles. Because U.S. vehicles generally cannot be serviced adequately in these countries, procurement is waived in favor of European and Japanese vehicles.

Another unclear aspect of the trade-aid relationship pertains to certain kinds of balance-of-payments support, wherein U.S. aid is not tied to specific items of U.S. procurement in advance but is associated with overall levels of imports from the United States. The most extreme example is Israel, whereby Israel commits itself to import U.S. goods at a level at least as high as U.S. economic assistance. In fact, the United States exported $3.1 billion to Israel in 1987 compared with economic assistance of $1.2 billion for overlapping fiscal year 1988. The question remains to what extent this association of aid and trade levels leads to more U.S. exports.

Economic aid and U.S. exports are indirectly linked to the extent U.S. aid promotes growth and a more open trading regime in the recipient country. Faster growth can lead to higher exports and imports. The resultant benefits to U.S. exporters are an important rationale for relating economic aid to growth in trade. The trade-oriented aid graduates in Asia and Latin America demonstrate the benefits. South Korea now imports more U.S. farm products in one year than the cumulative total of past U.S. economic assistance to that country. These indirect trade benefits, however, are long-term rather than immediate and available to all competitors, not just U.S. exporters.

One further qualitative aspect of the trade-aid relationship is commercial interest and the degree of influence it can have on the selection and design of aid projects. Such pressure inevitably exists where competitive companies seek contracts for their goods and services, and USAID projects offer lucrative potential for many U.S. firms. However, such commercial pressure is of relatively small consequence to the selection and design of U.S. projects. This reflects, in part, the decentralized USAID management structure, wherein mission directors justify their projects on development grounds. It also reflects the nature of basic-human-needs projects, where procurement can be dispersed among a number of suppliers of goods and services, each of relatively modest size. This is a critical distinction compared with the large capital-intensive projects discussed in the following section. In short, the bulk of the existing U.S. aid program, even when tied to U.S. procurement, is based on development objectives, and benefits to U.S. commercial interests are consequences rather than motivating factors.

## Capital Project Assistance

The trade-aid relationship for so-called capital project assistance is much more intensive than for basic-human-needs projects and is at the heart of growing concern among U.S. companies about adverse effects from other donor country programs. "Capital projects" have no precise definition, but the term usually refers to relatively large projects that have a high proportion of imported capital goods and that generally incorporate a high level of technology. The most prominent sectors involved are energy, telecommunications, and transportation. Such projects play a major role in many recipient country development strategies. They also constitute an important part of many bilateral donor programs, as well as those of the multilateral development banks. However, the selection and delivery of capital projects under current practices, particularly by bilateral donors, have serious shortcomings and problems for the United States for three related reasons.

First, such capital projects can be inefficient and costly in terms of development impact. They are not always subject to sound development criteria during the design and implementation phases. Projects can go forward outside investment priorities developed within established aid donor coordination mechanisms. Almost all bilateral projects are tied to national procurement in one way or another, reducing competitive bidding and selection of the most appropriate engineering design and technology, at considerable cost to the recipient country.

Second, capital projects have an important and, at times, overriding commercial orientation. They are in the sectors where donor countries compete head-to-head, in technology-intensive industries. Economic infrastructure projects in such sectors as telecommunications and power generation can establish technology standards favorable to future commercial sales by donor country companies. Consequently, strong export interests in donor countries can have substantial influence on the composition of aid programs, giving undue priority to capital projects compared with other forms of assistance. Relatively more aid also goes to middle-income developing countries, where there is greater demand for large capital projects, and relatively less aid goes to the low-income countries that need labor-intensive projects for the poorest people.

Third, there is striking asymmetry among bilateral aid programs regarding the relative role of capital projects. The United States provides a small portion of its aid in such projects; most other bilateral donors provide a much larger share. For the three sectors noted above—energy, telecommunications, and transportation—concessionally financed projects by bilateral donors reported to the DAC amounted to $3.2 billion in 1985, rising to $3.8 billion in 1986, totaling almost $7 billion over the 2-year period.[1] The largest providers were Japan, $2,934 million; France, $970 million; Germany, $963 million; the United States, $373 million; the United Kingdom, $291 million; and Canada, $287 million. As a percentage of total bilateral economic assistance, the diversity of concentration in capital projects is even more striking: Japan, 45.8 percent; Denmark, 33.0 percent; Norway, 22.5 percent; Germany, 20.8 percent; Italy, 17.0 percent; the United Kingdom, 15.4 percent; Canada, 14.0 percent; Sweden, 13.3 percent; France, 13.0 percent; and the United States, 2.3 percent.

A particular problem for capital projects arises in middle-income countries where commercial sales are most likely to be in direct competition with concessionally financed bilateral projects. Middle-income countries also have ready access to the World Bank and the regional development banks to finance capital projects, based on international competitive bidding, although such financing is essentially at commercial rates. A survey of ten middle-income countries,[2] mostly in East and Southeast Asia and Latin America, indicates, for the same three sectors in 1985–1986, a total of $1.3 billion of bilateral projects and $5.7 billion of multilateral development bank projects, or a share of 18 percent bilateral. The United States financed none of the bilateral projects. The balance between concessionally financed bilateral projects and multilateral development bank projects varied greatly by recipient country: the projects in Argentina, Brazil, Colombia, and Korea were funded almost 100 percent by multilateral development banks. Indonesia, Malaysia, Thailand, and Turkey showed the highest share for bilateral projects (27 to 71 percent). Another noteworthy distinction is the difference of bilateral versus multilateral project concentration among the three sectors: energy was 12 percent bilateral, transportation 25 percent, and telecommunications 83 percent. Apparently, telecommunications projects have such strategic commercial interest that other bilateral donors give highest priority to financing such projects on a concessionary basis, even to the point of squeezing out the multilateral development banks.

Preliminary and incomplete figures for 1987 indicate a very large increase, perhaps a doubling, in capital project financing compared with the 1985–1986 period. Germany, Italy, and Japan all more than doubled new project commitments in 1987 for energy, transportation, and telecommunications. Part of this increase reflects the revaluation of the dollar, but donors also increased capital project assistance to meet the competition. Such donor countries as Australia, Canada, and the United Kingdom, who have not been major suppliers of capital projects, are increasing the share of their aid resources devoted to such projects under pressure from their export industries. Ironically, the cheaper dollar, which has made U.S. exporters more competitive, is used as a major argument to expand concessionary financing of capital projects in some other donor countries.

The forms in which capital project assistance is provided vary considerably, can be complicated, and, at times, are secretive. European donors in particular provide a large part in the form of mixed credits, whereby grant aid is blended or cofinanced with export credits at commercial rates to achieve a given level of concessionary financing. The process for providing mixed credits can become competitive subsidized export financing, with little regard to development criteria or objectives. The recipient government, or in many cases a parastatal, enters into discussion with potential supplier companies seeking the best price and financial terms. Offers and counteroffers ensue until the recipient country chooses the most advantageous offer. The question is not whether the project has high development priority or whether the country deserves a higher overall level of economic aid, rather which exporting company wins the contract.

This environment of active export finance competition, in which the recipient country tends to expect some degree of concessionary financing on a wide range of large capital projects, is referred to informally within mixed credit agencies as spoiled markets, which currently include China and most of South and Southeast Asia. In these countries, mixed credit financial support is an increasingly routine response to requests from export industries. Nevertheless, some donors, such as France and Germany, report the entire financing of mixed credit projects as official development assistance, although most others report the concessionary portion of the financing package.[3]

## Japanese Capital Assistance

The Japanese capital projects program deserves special attention not only because of its size, which makes it the principal target of criticism by U.S. exporters, but also because Japan has given the greatest attention to bringing capital project assistance within a broader developmental framework. Since 1987, moreover, the Japanese government, the Diet, and private circles have discussed seriously how to increase further the developmental impact of Japanese aid and to reduce its trade distorting effects, particularly with the United States. If major change is to occur in reducing the trade distorting effects of capital project assistance, it will center on the relationship between Japan, the largest provider of such assistance, and the United States, the donor country suffering the greatest net adverse effect on its exports.

Japanese capital project assistance amounts to almost half of that provided by all donor countries and constitutes about 60–70 percent of Japan's total bilateral economic assistance. For energy, telecommunications, and transportation, Japanese projects totaled $1.6 billion in 1985, $1.4 billion in 1986, and $3.3 billion in 1987. Inclusion of other relevant sectors, such as integrated computer systems, high-tech hospitals, and industrial plants, would increase the total considerably.

Japanese economic aid is heavily concentrated in capital projects for several reasons. First, about 70 percent of Japanese aid goes to Asian countries, almost all of which are experiencing rapid industrialization. Such industrialization requires large investment in economic infrastructure. The Japanese, like many Asians, believe that aid should focus heavily on this critical area to stimulate development, and relatively less so on direct alleviation of poverty.

The second reason is severe management constraint. Japanese aid has always been concentrated in large projects that require minimal administrative support, in Tokyo and in the field. The Japanese government approves the projects, undertakes the financial commitments, then lets the engineering or consulting companies manage construction of the project. This contrasts sharply with the large, specialized field staff generally needed for projects in such sectors as rural health services and small-scale agriculture. In other words, a major shift from large capital projects to smaller, management-intensive social sector projects would require major restructuring and expansion of Japanese aid support staff capabilities.

Third, the Japanese have longstanding and pervasive commercial underpinnings for project selection and design. The official Japanese approach to project selection is to be reactive to requests from recipient governments. A potential recipient government submits a project request list to the Japanese government, usually annually. Then a Japanese interagency team reviews the list, and the Japanese government presents a final list of approved projects to the recipient government. In fact, however, considerable pre-project activity, including official grant assistance for feasibility studies and other technical support, can influence heavily the composition of the initial request list. Interaction between the representatives of Japanese companies and the ministries or parastatals that ultimately will receive financial support for the project can be intense, supporting clearly perceived mutual interests. Although some recipient countries, such as China, can manage this process within their own established priorities, other developing country governments have difficulty doing so when facing forceful, commercially driven relationships between supplier companies and eager, implementing ministries or parastatals within their own governmental structure.

The Overseas Economic Cooperation Fund (OECF), the Japanese implementing agency for development loans, has a unique form of tying Japanese aid to procurement. Most projects provide for procurement on an untied basis of internationally competitive bidding, but all projects, until recently, have tied the engineering-consulting services to Japanese firms.[4] However, because the engineering firm draws up the detailed engineering specifications and often manages procurement for the project, Japanese companies have an advantage in bidding on procurement. Anecdotal evidence supports special relationships and verbal understandings that procurement will go to Japanese firms, especially for the large, high-technology equipment involved. Japanese officials maintain that procurement is indeed open to competitive bidding but that U.S. companies, in particular, choose not to bid. They also provide figures indicating that a substantial share of procurement goes to non-Japanese sources, but such figures are aggregate and could relate to necessary local procurement and to low-technology inputs. There is no evidence that non-Japanese firms have won bids on big-ticket, high-technology components of capital projects.

In view of these circumstances and perceptions, critics, particularly U.S. companies and members of Congress, believe that commercial interests drive Japanese economic aid, with a resulting adverse impact on U.S. exports. The Reagan administration has concurred in the assessment that current practices for capital project assistance result in a substantial net adverse impact on U.S. exports.

The Japanese themselves increasingly debate the interaction of the commercial and developmental dimensions of their aid program. Some people in the government and private circles are calling for a more development-oriented aid program, including greater emphasis on direct poverty alleviation, more fast disbursing balance-of-payments support where policy reform programs are underway, and a "country development strategy" approach, along the lines of USAID practices (rather than the reactive approach). In 1986, for example, Japan adopted a $500 million program, over three years, of grant balance-of-payments support for the low-income countries, mostly in sub-Saharan Africa, that constituted a new form of Japanese aid. Japan untied the engineering-consultancy loans to South Korea and Malaysia in April 1987 and announced the intention to do the same for the Philippines and Thailand around 1990. Japan also has increased loans for fast disbursing commodity import programs in certain Asian countries. It is still not clear whether, in the aggregate, the share of aid devoted to capital project assistance is diminishing in any significant way because the overall level of Japanese aid is growing rapidly. However, change is taking place in certain aspects of the Japanese program, and momentum is building for further change.

In sum, although the Japanese aid program favors capital project assistance with strong commercial underpinning, sentiment is rising to change this orientation and to move toward a more developmentally focused program with less trade distorting effects. Because procurement for most capital projects is generally untied and even some engineering services are becoming untied, Japan, in policy terms, leads all other donors who, with few exceptions, fully tie capital projects to national procurement.

## Recent U.S. Efforts

In response to the growth of capital project assistance by other donors and the corresponding growing concern of U.S. companies, the United States has taken several actions over the past few years to deal with the asymmetry among donors in support for capital projects and the resulting adverse impact on U.S. exports. The results to date, however, have been modest at best.

In 1982 USAID established the Trade Financing Facility in Egypt for mixed credit projects and used the facility to finance two projects totaling $53 million in the electric power sector. In 1984 USAID and the U.S. Export-Import (EXIM) Bank established a broadly based mixed credit program to provide financing for U.S. firms bidding on developmentally justified projects on terms comparable with those offered by other donor countries. The grant element of such mixed credits was to come from the Economic Support Fund (ESF), which has been heavily constrained by spending earmarks and declining overall levels. ESF for mixed credit financing was "not more than $5 million" in each of fiscal years (FY) 1987 and 1988, as stipulated in the aid appropriation. Since its initiation, the program has made mixed credit offers to U.S. companies on four occasions. On one occasion the U.S. company won the contract, for a project totaling $27 million. Obviously, this program, despite its design along the lines of some European mixed credit programs, has never received enough funding to have a significant impact.

In FY 1987 the United States began a separate program within the EXIM Bank called the "War Chest," and allocated $100 million of EXIM funds to provide the grant element for concessionally financed loans. If, for example, blended loans contain a 40 percent grant element to meet competitive financing by other donor countries, $100 million in budget authority would finance about $250 million in total projects. EXIM in fact approved almost $250 million of War Chest projects in FY 1987.

The administration did not intend the EXIM War Chest, however, to be a permanent program to bridge commercial and development objectives. It was primarily designed as an incentive to negotiations within the OECD to place more stringent conditions on the use of tied aid credits by all donor countries. The principal results of OECD negotiations concluded in spring 1987 were that the minimum grant element for tied aid credits would be increased in two stages from 25 to 35 percent by July 1988 and that the basis for calculating the grant element would be brought in line with actual market rates of interest. The net result is that tied aid credits to fund such projects becomes more expensive, which should exercise some restraint on their use. It is still too soon to assess the actual impact of the agreement, but indications are that tied capital project programs, however restrained, will continue at current, if not higher, levels for reasons other than the cost of financing.

The most recent U.S. initiative was to raise within the DAC the aid-trade relationship for capital projects in broadest terms, in order to see whether a more harmonized approach is possible that would serve mutually agreed development objectives while reducing or eliminating trade distorting effects. This would certainly be preferable to a competitive race of mixed credit programs at the expense of other development needs, particularly in the poorest countries.

After initial discussions in 1987, the United States made five proposals for such a harmonized approach at the December annual ministerial level meeting of the DAC, the highlights of which are as follows:

1. A General Untying of Capital Projects. All capital projects would be untied to international competitive bidding. As a practical matter, this process could begin by focusing on projects of a minimum size and in selected sectors. Untying would include the consultancy-engineering portion of capital projects even though this is a complex area in terms of prequalifica-

tion and selection. The proposal is based on reciprocal actions by all bilateral donors under clearly established procedures to ensure full compliance.

2. Strengthened Development Criteria. This would consist, to a large extent, of elaborating and adopting for capital projects the best practices for project selection, design, and implementation currently under discussion within the DAC. It would include such criteria as economic rate of return, projected financing of recurring costs, beneficiary analysis to include impact on alleviating poverty, environmental impact, compatibility with existing and planned infrastructure technology, and consistency with more broadly based policy reform measures. Particular attention would be given to ensure that public sector capital projects do not squeeze out investment opportunities for the private sector. When recipient countries engage in donor coordination mechanisms, such as World Bank consultative groups and United Nations Development Program roundtables, capital project financing should fit within priorities established in the host country public investment program. For large projects, in particular, some form of multilateral vetting would be built into donor coordination procedures.

3. More Flexible Availability of Technical Support. Donor agencies supply substantial amounts of technical support, such as feasibility studies, consultants, training, and equipment, to support capital projects, particularly at the early, pre-project stages. This technical support could be provided in a more coordinated and open manner in order to give the host government the broadest selection of services at the lowest cost.

4. More Responsive Assistance for Low-Income Countries. For sub-Saharan Africa, the World Bank is proposing a greater proportion of fast disbursing assistance, thus emphasizing less capital projects. For the poorest countries, DAC members have agreed on a general target of total grant assistance and on a minimum grant element of 50 percent for certain tied loan assistance. A broader set of criteria for the relative roles of capital projects and other forms of assistance should incorporate these objectives. Implementation of agreed criteria could take place within donor coordination mechanisms generally in effect for low-income countries.

5. A Coordinated Transition for Middle-Income Countries. These are countries where commercial sales are most likely to be in direct competition with concessionally financed projects, and formal donor coordination is less likely. In some such countries, most or all donors no longer offer concessionally financed capital projects, but major capital project programs are still underway by the multilateral development banks. Common criteria should be developed for phasing down concessionally funded bilateral projects as recipient countries achieve middle-income, more industrialized status. In parallel, greater scope could be given to export credit agencies and multilateral development banks for appropriate capital projects, while bilateral concessional assistance focuses on cofinancing multilateral development bank projects and direct alleviation of poverty.

Detailed discussion of these U.S. proposals within the DAC began early in 1988. Initial reactions by other donors were mixed and not encouraging. Some progress was made on developing agreed criteria for project selection and appraisal, although resistance was evident to multilateral vetting of the implementation of the criteria for large projects. Improved pre-project technical support needs to begin with fact-finding on existing practices. Bilateral donors, in close collaboration with the World Bank and other international financial institutions, are pursuing a more balanced and responsive approach for low-income countries, especially in sub-Saharan Africa. The objectives for a coordinated transition of middle-income countries were recognized as important, but a detailed exchange of views has not yet taken place.

The most far-reaching U.S. proposal is the call for a general untying of procurement, including engineering services, for large capital projects. Most other DAC members strongly resisted or opposed this proposal. Some donor countries explained that their domestic constituents support such projects because the projects are tied to domestic procurement and that to untie them could result in throwing out the baby with the bath water. The United States responded that similar industry-based constituencies are exerting growing pressures in the United States to adopt large capital project programs of its own in order to establish an even playing field with export credit practices of other donor countries. In other words, the existing situation is not stable or tenable over time.

Further discussion of the U.S. proposals continues, and the DAC ministerial level meeting in December 1988 will likely review the subject to assess progress and to explore further steps. At least, a clearer picture will emerge by the end of the year as to the disposition of other donor countries to move toward a more harmonized approach for capital project assistance that will give greater emphasis to development criteria and that will reduce trade distorting effects.

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## Policy Recommendations

The United States and other major donor countries could find 1989 a watershed for their development strategies. Since the late 1960s and 1970s the United States has been at the forefront of a development emphasis on direct alleviation of poverty—the basic-human-needs approach—including the role of private voluntary organizations and support for small enterprises. In the 1980s bilateral donors and the multilateral development banks also have given prominence to the provision of fast disbursing assistance in support of policy reform efforts by recipient country governments. Discussion of development assistance policy continues to highlight these areas of support and various efforts to rethink development strategy underway in the United States during 1988 generally limit themselves to a revaluation of these continuing programs.

Meanwhile, economic infrastructure and industrial projects continue to constitute the largest share of multilateral development bank financing and an apparent increasing proportion of many other bilateral donor programs as well. The importance of capital project assistance and its direct bearing on export competition among donor countries, however, receives relatively little attention. Within multilateral development banks, debate centers on non-project and other new forms of assistance, while the "bricks and mortar" cadres of engineers and technical support staff involved in capital projects are left in the shadows.[3] Other bilateral donor aid agencies are even more reluctant to give prominence to capital project assistance. Their professional staffs are basically development-oriented and their hearts are not in their mixed credit programs with all the incumbent commercial considerations. Moreover, they have been very much on the defensive vis-à-vis the United States with respect to the OECD tied credit arrangement and the DAC proposals; therefore, they would much prefer to downplay or set aside this whole subject.

Within the U.S. government, capital project assistance is also something of an orphan. USAID has a few large infrastructure projects on a grant basis principally in Egypt and Pakistan, but it is not engaged in the fast moving competition among mixed credit programs to bid on large capital projects. The U.S. mixed credit program, although administered by USAID, has not had the financial resources to develop significantly. The EXIM Bank implements the substantial War Chest program but considers itself an export financing facility, and in no way a development agency. The EXIM Bank did not report to the DAC the $250 million of War Chest projects in FY 1987, for example, as official development assistance for this reason, even though other donors do so for their mixed credit programs. The Department of the Treasury, which might play a bridging role between the development and trade dimensions of capital project assistance, is also divided organizationally—one section is concerned with export finance, another with development assistance, and there is not much interaction between the two.

Congressional committees face similar bifurcation in their jurisdictional domains. The four authorizing and appropriating committees for aid legislation focus almost entirely on basic-human-needs projects, policy reform, and other developmental objectives. Chairman Don Bonker of the Trade Subcommittee of the House Foreign Affairs Committee has championed interest in the commercial dimension of aid programs, largely in vain attempts to obtain significant designated funding for the mixed-credit program. With his departure from the House to run for the Senate, it is not clear where House interest in the trade-aid relationship will gravitate. In May 1988 Chairman Robert Garcia of the House Banking Subcommittee on International Finance, Trade and Monetary Policy held a hearing on aid and trade related to his jurisdiction over EXIM Bank budget authority. Senate interests in the commercial aspects of economic aid are even more difficult to identify.

As a result, the U.S. response to the trade implications of capital project assistance has thus far been piecemeal and not very effective. The United States' only comprehensive attempt—the DAC proposals—is at a disadvantage because the United States does not have a substantial capital project program of its own. Americans are asking others to make major, difficult program changes, with no U.S. bargaining chips other than moral suasion and a veiled threat of indirect action in the trade field.

It is time for the United States to undertake a more forceful approach in dealing with the important issue of interaction between aid and trade interests, particularly with current practices of capital project assistance. Such an approach could consist of the following elements:

1. Recognize the major development role of capital project assistance, particularly in the semi-industrialized and more advanced developing countries that constitute the large majority of the developing world. Because such

project assistance can have a high degree of commercial sensitivity for donor countries, project selection and delivery therefore need to take account of both the developmental and commercial consequences involved.

2. Reformulate U.S. development assistance objectives to include an appropriate role for capital project assistance, taking account not only of developmental and foreign-policy objectives but also of U.S. commercial interests as well.

3. Restructure existing bilateral USAID programs in support of the reformulated set of objectives. Some initial changes may be possible without a radical restructuring. In some existing country programs, for example in the Philippines and Indonesia, the United States could simply shift the composition of its programs toward major funding of capital projects, while other donors, particularly Japan, could give greater emphasis to balance-of-payments support and basic-human-needs assistance.

4. Reconstitute and strengthen the U.S. mixed credit–War Chest programs. These hastily launched efforts have serious shortcomings, including the lack of dedicated funding for the mixed credit program and the absence of any development consideration for the War Chest. The objective would be to meet the competition of other donors within clear development guidelines. The evolving Japanese OECF program would be a better model than the more blatantly commercial operations of some European mixed credit programs. Such a reconstituted U.S. program could be for a limited period of time linked to progress on the U.S. DAC proposals. The program would require funding from budget allocations but with the prospect of a program much larger than the budget allocation because the grant element for such projects would only be in the order of 35–40 percent. For example, $0.5–1.0 billion could finance projects on the order of $1.3–3.0 billion, which would have substantial impact.

5. Pursue the U.S. DAC proposals for a more harmonized approach with other donors, based on strengthened development criteria for all capital projects, and phasing out tied bilateral projects in favor of multilateral development bank financing in the more advanced, middle-income countries.

6. Create an appropriate support structure within the executive branch. None exists now, but there are various ways of doing so. One interesting possibility would be a greatly expanded role for the Trade and Development Program (TDP), which has been quite successful in providing feasibility studies and other technical support for development projects with potential for U.S. exports.

These specific steps, of course, should form an integral part of a comprehensive, forward-looking development strategy for the 1990s, the elaboration of which is beyond the scope of this presentation. The general lines for such a strategy, however, are increasingly clear. The concept of a monolithic Third World has always been misleading, and the diversity of circumstances and interests among developing countries continues to widen. The poorest countries, principally in sub-Saharan Africa, South Asia, and the Caribbean, remain highly dependent on fast disbursing grant aid. Direct alleviation of dire poverty is an indisputable major part of economic assistance at this stage.

For much of the developing world, however, the industrialization process is well launched and proceeding rapidly. Development strategy, commercial interests, and capital project assistance, in particular, closely interact, and the policy response by donor countries needs to take them all into account. To illustrate the enormous stakes, a recent USAID report on power needs in developing countries pointed out:

> The electric power sector in developing countries provides a major market opportunity for equipment and services ranging from $370 to $900 billion over the next twenty years. United States exports now represent less than 10 % of the total power generation equipment and services exports to developing countries, down from 17 % just five years ago and down from over 20 % in the late 1970's.[6]

The USAID report presents a three-pronged approach for meeting these projected needs and avoiding widespread power shortages in developing countries: rapid adoption of improved technology to increase energy efficiency, a restructuring of electricity tariffs, and a lowering of barriers to private sector participation in power development. These are all sound and essential steps, but there is an additional dimension of the problem, namely the provision and financing of new power generating plant, equipment, and technology by industrialized country suppliers. This is the world of capital project assistance, where development and commercial interests are inextricably linked. Capital project assistance is also a key element of evolving U.S. economic interests in the Pacific Basin, much of Latin America, and other newly industrializing parts of the world. The United States needs to have a concerted policy response for dealing with this relationship and preferably a leadership role to support U.S. companies with the new technologies that form the basis for the industrial transformation underway in most of the developing world.

## Notes

1. These and all subsequent figures on recent capital project assistance are from the testimony of Ernest H. Preeg before the Subcommittee on International Finance, Trade and Monetary Policy of the House Committee on Banking, Finance and Urban Affairs, May 4, 1988.
2. Argentina, Brazil, Colombia, Indonesia, South Korea, Malaysia, Mexico, the Philippines, Thailand, and Turkey.
3. The definition of official development assistance, as agreed by DAC members, stipulates that the concessionary financing is primarily motivated by development objectives.
4. More precisely, the engineering-consulting services are "LDC untied," which means that developing country engineering firms can seek to qualify for such services. In practice, Japanese firms are used.
5. One aspect of current multilateral development bank practices that needs to be drawn out of the shadows is the near total reliance on public sector entities for economic infrastructure projects. Far greater private sector participation is feasible and desirable, but this important matter is beyond the scope of this paper.
6. *Power Shortages in Developing Countries: Magnitude, Impacts, Solutions, and the Role of the Private Sector* (Washington, D.C.: U.S. Agency for International Development, March 1988), p. 2.

Senator **Sarbanes**. Thank you very much, Mr. Armenian. It is a very helpful statement.

Mr. Kittredge, we will be happy to hear from you.

## STATEMENT OF FRANK D. KITTREDGE, PRESIDENT, NATIONAL FOREIGN TRADE COUNCIL, INC, WASHINGTON, DC

Mr. **Kittredge**. Thank you, Mr. Chairman.

My name is Frank Kittredge, President of the National Foreign Trade Council, an association of approximately 500 members involved with international trade and investment and, I think significant here, accounts for about 70 percent of U.S. exports.

Mr. Chairman, we submitted written testimony which I hope will be made part of the record.

Senator **Sarbanes**. The full statement will be included in the record.

Mr. **Kittredge**. We are pleased to have the opportunity to testify on tied aid credits, a subject which obviously has had substantial impact, and substantial negative impact, on our companies: lost competitiveness, lost exports, lost markets, lost jobs.

The subject is not new to this committee. You have been involved since at least 1983, as I understand it. But it has had—and I think that we should not miss this point—a significantly greater impact in recent years.

### INCREASE IN TIED AID ACTIVITY

The first point I would like to make is, there has been—and I want this to be clear—a tremendous increase in the tied aid activity over the past number of years. In our testimony on page 6—and it is not necessary to turn to it, but on table 3, the long-term official credits, if you will, official OECD credits, in 1982 were 16.1 billion. They have gone down to 9.7 billion in 1988. In fact, in 1987 they were as low as 6.4 billion.

At the same time, the tied aid credits that we are talking about here, from OECD countries, have gone from 9.4 billion in 1982 up to 12.4 billion in 1988. There are many more players in the picture. Obviously, OECD is only about 75 percent of that number. Spain, Australia, the Scandinavian countries, and even now Korea and Taiwan are in the picture. We can only guess what that is going to mean.

Second, the United States is just not a player. It has been mentioned before, but it is worth restating it. Within those numbers above in the 9.7 billion of official credits in 1988, the United States had only 700 million. In the tied aid portion of it, in 1988, the 12.4 billion, the United States had 400 million only. I think that is dramatic.

Now there are also numbers in this testimony on page 3, Table 1, that show that in 1987 the OECD countries offered a little more than $12 billion worth of mixed credits. Of that amount, the United States was $200 million.

As was mentioned earlier, at the top of the list is Japan at $5.4 billion, France 2.3, the U.K. $2.1 billion, and Italy $2 billion, which is a surprise—or perhaps not a surprise.

All of this, of course, has meant a significant loss of business to our companies. The ExIm study that was mentioned earlier quotes 400 to 800 million yearly. Actually, that has to be adjusted for the addition of all industries and all companies. It has to be increased for those projects that never reach the market place, that are not bid. It has to be increased for projects that have over a 50 percent concession rate; that were not included. And it has to be adjusted for 1989 dollars.

If you do all of that, you are looking at an estimated loss of exports somewhere around 2.5 to 5 billion dollars. And obviously, a loss of associated jobs.

We estimate that $1 billion worth of lost exports is worth somewhere around 20,000 jobs, and that looks to be about $50,000 annually just on that basis.

One thing I would like to point out here, in certain industries there is a particular crunch that develops. First of all, you get lost LDC exports because of the tied aid offers of other OECD countries. Second, we look at closed OECD home markets. Just try to get some of our capital goods products into Germany, France, and the U.K., and see what happens. Most of our manufacturers cannot even bid in those markets.

A declining U.S. market in some of these product areas, particularly recently. And then, you add the fact that these OECD competitors, like Seamans, Hitachi, Toshiba, are free to operate in this the U.S. market against U.S. competitors, and you have an unusually difficult situation—not exactly a marketing manager's dream; maybe a nightmare, but not a dream.

## LOSS OF FOLLOW-ON THE SALES

It also means a loss of follow-on sales. I think that is especially important, because these are new, growing markets. These are door-opening opportunities. China was mentioned a bit ago. In the early 1980's and mid-1980's, China was the market. It was the last big capital goods market for many U.S. manufacturers. But the U.S. participated very little, because of the enormous amount of tied aid credits that were offered.

Competition gets in on the ground floor through tied aid, and the markets become theirs, not the U.S.'s markets. I do not think anybody misses the fact that this is a conscious, predatory strategy by all of the OECD competitors to capture these markets and to retain them.

Last, there is a significant loss of U.S. influence. I am not sure anybody worries about this, but it bothers some of our companies. These are important developing countries to the U.S. These are large infrastructure projects that are of major importance to key officials in these countries. They watch them very closely.

If the U.S. succeeds, we have close contact, involvement, and close association with these governments. If we lose them, it's the Germans, the Japanese, the French, and now perhaps the Koreans and the Taiwanese who are involved.

So everybody knows the magnitude of the problem. It has been stated by many. What should be done? Perhaps I should say here—and I do not want to repeat what Mr. Armenian has just said—that our companies would much prefer the whole thing went away. We will compete against any one of these competitors on price, technology, delivery, service, whatever; but it is impossible to compete in some of these markets, as has been said by many people, with the playing field as distorted as it is today.

And unfortunately, it does not look like that is going to change right away. So some approaches must be considered. Our companies would recommend that first a firmly reauthorized War Chest tied aid fund be established—and that it be established with some clout; so it will command respect at the bargaining table.

In our view, $200 million is a minimum for this War Chest. It ought to be for at least 2 years. It does not seem to us that any negotiator sitting in front of the OECD countries—as was pointed out by Senator Bond—facing the values of the OECD competitors, $3.4 billion by the Japanese, or 2 billion by the United Kingdom, can consider $100 million to be a credible number against that kind of competition?

As has been pointed out, a $200 million War Chest would support a $500 million tied aid program, and that would begin to have some teeth in it. It is not $3.4 billion, and we have to recognize that, but at least it would have the ability to target key areas and to agressively pursue the marketplace.

But the War Chest should not come from the direct credit program. Senator Heinz pointed out very clearly, the more you develop that War Chest, the less you have for direct credits. There are lots of direct credit programs that still need support, from small and large manufacturers alike.

Last, as has also been pointed out, it should be an offensive, not a defensive weapon. In this past manufacturers have been told, "If you can bring us proof that our partners, our trading partners, are breaking the OECD rules, we will help you." That is almost impossible to do. As a passive weapon, it has been very unsuccessful.

Second, a capital projects program should be established within aid. It seems to our companies that there should be no legitimate reason why some aid money should not be used to support capital infrastructure projects which have a clear developmental role.

Such a program should operate on sound development criteria, and not on commercial considerations, which is what is happening now.

Finally, we do believe that multilateral negotiations should be entered into with our trading partners, to find some way to reach agreement that capital project assistance be offered on economic development grounds only, and therefore to eliminate the commercially motivated mixed credit support that is going on now.

These negotiations should be approached with adequate resources, in the form of a viable War Chest and a substantial direct credit program; so that we can demonstrate the seriousness of the U.S. intention, and to give our negotiators the leverage to force an end to this trade distorting practice. I might add, it would also enhance the United States's own mixed credit program if the negotiations fail or are of a very protracted nature.

That is short, but that is what we believe and what our companies believe. Thank you for the chance to testify.

[The complete prepared statement of Frank D. Kittredge follows:]

# PREPARED STATEMENT OF FRANK D. KITTREDGE
PRESIDENT
NATIONAL FOREIGN TRADE COUNCIL, INC.

before the

SUBCOMMITTEE ON INTERNATIONAL FINANCE AND MONETARY POLICY
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
WASHINGTON, D. C.

SEPTEMBER 13, 1989

GOOD MORNING, MR. CHAIRMAN.

MY NAME IS FRANK KITTREDGE, PRESIDENT OF THE NATIONAL FOREIGN TRADE COUNCIL (NFTC). I AM PLEASED TO TESTIFY BEFORE THIS COMMITTEE TODAY ON THE SUBJECT OF TIED AID CREDITS AND THE EFFECTS THAT THE TIED AID CREDIT PRACTICES OF OTHER COUNTRIES HAVE ON U.S. EXPORTS AND OUR INDUSTRIAL COMPETITIVENESS.

THE NFTC IS THE LARGEST AND OLDEST ASSOCIATION FORMED TO ADDRESS INTERNATIONAL TRADE AND INVESTMENT ISSUES, WITH MORE THAN 500 CORPORATE MEMBERS WHO ACCOUNT FOR MORE THAN 70% OF U.S. EXPORTS. TIED AID CREDITS HAVE HAD A SUBSTANTIAL IMPACT ON MANY OF OUR COMPANIES, AFFECTING THE VOLUME OF THEIR EXPORTS TO THIRD WORLD MARKETS, AND IN MANY CASES, SERIOUSLY ERODING THEIR PRODUCTIVE CAPACITY HERE AT HOME. THERE ARE FEW TRADE PROBLEMS WE CURRENTLY FACE WHICH APPROACH THE MAGNITUDE, IN TERMS OF LOST EXPORTS, JOBS AND COMPETITIVENESS, OF THE TIED AID ISSUE. MOST DISTRESSING IS THE FACT THAT OUR GOVERNMENT HAS NO EFFECTIVE POLICY OR MECHANISM WHICH ALLOWS US TO RESPOND AGGRESSIVELY TO PROTECT U.S. INDUSTRY.

THE PROBLEM OF TIED AID IS CLEARLY NOT A NEW ISSUE TO THIS COMMITTEE, WHICH IDENTIFIED A NUMBER OF YEARS AGO THE DAMAGING EFFECTS OF TIED AID CREDIT PRACTICES. THE FIRST PROPOSAL TO PROVIDE A WAR CHEST TO FIGHT MIXED CREDIT COMPETITION CAME OUT OF THIS COMMITTEE ALMOST A DECADE AGO. THIS COMMITTEE HAS A HISTORY OF LEGISLATIVE ACTION IN THIS AREA, BEGINNING IN 1983 WHEN CONGRESS DIRECTED THE EXPORT-IMPORT BANK AND U.S.A.I.D. TO

ESTABLISH A PROGRAM TO ASSIST U.S. EXPORTERS FACING TIED AID CREDIT COMPETITION. IN 1986 THIS COMMITTEE WAS CRITICALLY INVOLVED IN THE LEGISLATION WHICH ESTABLISHED THE TIED AID CREDIT FUND, OR "WAR CHEST", TO LEND CREDIBILITY TO U.S. NEGOTIATING EFFORTS TO COMBAT PREDATORY FINANCING PRACTICES OVERSEAS. BECAUSE THIS COMMITTEE AND OTHERS IN THE CONGRESS WERE CONCERNED THAT THE TIED AID CREDIT PRACTICES WERE INCREASING DESPITE A 1987 O.E.C.D. AGREEMENT TO TIGHTEN THE RULES GOVERNING TIED AID CREDITS, A NUMBER OF PROVISIONS TO STRENGTHEN OUR TIED AID PROGRAM WERE INCLUDED IN THE OMNIBUS TRADE AND COMPETITIVENESS ACT OF 1988.

AS YOU KNOW, TIED AID CREDITS INVOLVE HIGHLY CONCESSIONAL LOANS OR GRANTS WHICH ARE COMBINED WITH STANDARD OFFICIAL EXPORT CREDITS TO PURSUE SPECIFIC COMMERCIAL OBJECTIVES IN A NUMBER OF LESS DEVELOPED COUNTRIES. THE 1987 INTERNATIONAL AGREEMENT ON TIED AID RAISED THE MINIMUM CONCESSIONAL OR GRANT ELEMENT IN THESE TRANSACTIONS FROM 25 PERCENT TO 35 PERCENT OR MORE OF THE VALUE OF THE EXPORT SALE. WHILE THE INTENT OF U.S. NEGOTIATORS IN PRESSING FOR THIS AGREEMENT WAS TO END TIED AID PRACTICES, THE ONLY REAL EFFECT OF THE NEGOTIATIONS HAS BEEN TO MAKE IT MORE EXPENSIVE. THE PRACTICE HAS NOT BEEN ELIMINATED, AND THE U.S. FINDS IT MORE DIFFICULT THAN EVER TO COMPETE.

O.E.C.D. DATA SHOW A CONTINUING INCREASE IN THE NUMBER OF COUNTRIES THAT ARE USING TIED AID CREDITS TO GAIN COMPETITIVE ADVANTAGE OVERSEAS. ONLY A HANDFUL OF DEVELOPED COUNTRIES

OFFERED AID SUPPORT TO PUSH EXPORT SALES IN 1980. DURING THIS DECADE WE HAVE COME TO SEE ALL OF THE INDUSTRIAL WORLD INDULGE IN THIS PRACTICE. FURTHERMORE, THE EXPORT-IMPORT BANK'S RECENT "REPORT TO THE U.S. CONGRESS ON TIED AID CREDIT PRACTICES" CAREFULLY DOCUMENTS THE TIED AID STRATEGIES OF OTHER COUNTRIES. THIS ANALYSIS CLEARLY SHOWS HOW CONCESSIONAL FINANCING MECHANISMS HAVE BECOME ENTRENCHED THROUGHOUT THE INDUSTRIALIZED ECONOMIES. THESE ARE POLICIES WHICH WILL NOT EASILY BE ABANDONED.

TABLE I ILLUSTRATES HOW TIED AID CREDIT OFFERS BY OUR MAJOR TRADING PARTNERS HAVE INCREASED OVER THE PAST SEVERAL YEARS, FROM $5.1 BILLION IN 1984 TO $ 12.4 BILLION IN 1987. IT IS ESTIMATED THAT TIED AID CREDIT OFFERS ARE BEING SUSTAINED, IF NOT BEING INCREASED ABOVE THIS LEVEL.

### TABLE I

OECD NOTIFICATIONS OF TIED AID CREDITS BY COUNTRY -- 1984 TO 1987 IN MILLIONS OF U.S. $

| | 1984 | | 1985 | | 1986 | | 1987 | |
|---|---|---|---|---|---|---|---|---|
| Country | Total | % | Total | % | Total | % | Total | % |
| Canada | 347 | 6.8 | 1241 | 15.3 | 1119 | 11.6 | 843 | 6.8 |
| France | 1666 | 32.6 | 1595 | 19.7 | 869 | 9.0 | 2319 | 18.7 |
| Germany | 1242 | 24.3 | 1552 | 19.1 | 1647 | 17.1 | 1407 | 11.3 |
| Italy | 436 | 8.5 | 711 | 8.8 | 1230 | 12.8 | 2062 | 16.6 |
| Japan | 181 | 3.5 | 1448 | 17.9 | 2875 | 29.8 | 3474 | 28.0 |
| U.K. | 1155 | 22.6 | 991 | 12.2 | 1646 | 17.1 | 2113 | 17.0 |
| U.S.A. | 89 | 1.7 | 574 | 7.1 | 246 | 2.6 | 205 | 1.7 |
| TOTALS | 5116 | 100.0 | 8112 | 100.0 | 9632 | 100.0 | 12423 | 100.0 |

MOST STRIKING ABOUT THE DATA IS THE FACT THAT THE UNITED STATES IS CLEARLY NOT A PLAYER IN THIS SPECIAL TRADE FINANCE GAME. IN 1987, THE MOST RECENT YEAR CITED BY EXIMBANK IN ITS

REPORT, THE U.S. OFFERED $205 MILLION IN TIED AID, OR 1.7% OF THE OFFERS EXTENDED BY THE MAJOR TRADING COUNTRIES. JAPAN'S OFFERS TO SUPPORT ITS EXPORTERS WERE 17 TIMES WHAT THE U.S. CHOSE TO OFFER. FRENCH OFFERS WERE 12 TIMES GREATER THAN THE U.S. LEVEL. CANADA, THE LEAST FORMIDABLE OF OUR COMPETITORS IN TERMS OF TIED AID VOLUME, OFFERED 4 TIMES THE SUPPORT THE U.S. COULD MUSTER.

WHAT MUST BE UNDERSTOOD IS IN LOSING OUT IN TIED AID COMPETITION WE ARE BECOMING UNCOMPETITIVE IN TRADE FINANCE GENERALLY. TODAY THE BULK OF THE EXPORT CREDIT ACTIVITY OF GOVERNMENTS INVOLVES TIED AID. TO GAIN COMPETITIVE ADVANTAGE OUR TRADING PARTNERS HAVE SUBSTANTIALLY SHIFTED THE FOCUS OF EXPORT SUPPORT AWAY FROM CONVENTIONAL FORMS OF OFFICIALLY SUPPORTED EXPORT CREDIT. TABLE II ILLUSTRATES THAT THE SEVEN MAJOR EXPORTING COUNTRIES PROVIDED APPROXIMATELY $6 BILLION IN OFFICIAL EXPORT CREDITS IN 1987.

TABLE II

VOLUME OF BUSINESS SUPPORTED BY
OFFICIAL EXPORT CREDITS IN 1987
(US$, MILLIONS)

| Countries | $ Volume | % of Total Exports |
|---|---|---|
| United States | 998 | 4.7 |
| Canada | 497 | 6.3 |
| France | 1,997 | 16.8 |
| Germany | 729 | 3.0 |
| Italy | 345 | 3.6 |
| Japan | 859 | 4.5 |
| United Kingdom | 666 | 6.1 |
| TOTAL | 6,091 | |

Sources: Export-Import Bank, "Report to the U.S. Congress on Export Credit Competition...," (June 1988). OECD, "Monthly Statistics on Foreign Trade" (Series A).

THE $6 BILLION IN OFFICIAL CREDITS IS UNDER ONE HALF THE AMOUNT THESE SAME COUNTRIES OFFERED IN TIED AID CREDIT ($12.4 BILLION) DURING THE SAME YEAR.

TABLE III DOCUMENTS THE TREND TOWARD THE DISPLACEMENT OF CONVENTIONAL EXIMBANK-TYPE OFFICIAL CREDITS BY TIED AID SUBSIDIES. THIS DEVELOPMENT IS MADE ESPECIALLY EVIDENT WHEN THE LONG TERM OFFICIAL CREDIT PORTION OF A MIXED CREDIT IS MOVED FROM THE OFFICIAL CREDIT CATEGORY TO THE TIED AID CATEGORY. WHEN TOTAL OFFICIAL EXPORT SUPPORT IS REGARDED IN TERMS OF BOTH CONVENTIONAL AND TIED AID PROGRAMS, THREE POINTS ARE CLEAR. FIRST, THE BREAKDOWN IN THE TABLE SHOWING THE U.S. PORTION OF O.E.C.D. CREDITS AND CAPITAL PROJECT ASSISTANCE SHOWS THAT THE U.S. PROVIDES OFFICIAL SUPPORT FOR SUBSTANTIALLY FEWER EXPORTS THAN MOST INDUSTRIALIZED COUNTRIES.

SECOND, THE DECLINE IN FINANCE SUPPORT IS ACCOMPANIED BY A CORRESPONDING DECLINE IN THE U.S. SHARE OF THE WORLD'S CAPITAL EQUIPMENT/PROJECTS MARKET. THE ADVERSE EFFECTS OF A FIFTY PERCENT DECLINE FROM 1982 TO 1988 OF THE U.S. SHARE OF TOTAL BILATERAL FINANCING FOR CAPITAL PROJECTS ARE NOT HARD TO IMAGINE.

THIRD, AND MOST IMPORTANT, THE WORLD'S CAPITAL EQUIPMENT MARKET IS INCREASINGLY INACCESSABLE TO U.S. EXPORTERS LARGELY BECAUSE THE U.S. DOES NOT OFFER TIED AID SUPPORT. BETWEEN 1986 AND 1988 THE TOTAL AMOUNT OF LONG TERM OFFICIAL EXPORT CREDITS OFFERED AT O.E.C.D. RATES INCREASED BY 24 PERCENT (FROM $7.4 TO

$9.7 BILLION). HOWEVER, DIRECT CREDIT SUPPORT AVAILABLE TO U.S. EXPORTERS DECREASED BY 50 PERCENT DURING THE SAME PERIOD. BETWEEN 1986 AND 1988 TOTAL TIED AID COMMITMENTS, INCLUDING MIXED CREDITS, INCREASED BY 40 PERCENT (TO $12.4 BILLION) WHILE U.S. SUPPORT REMAINED CONSTANT. THE OTHER SOURCE OF COMPETITIVE FUNDING AVAILABLE TO U.S. CAPITAL GOODS PRODUCERS, THE MULTILATERAL DEVELOPMENT BANKS, REMAINED STABLE DURING THE 1986-1988 PERIOD. THUS, IN TERMS OF THE TOTAL $25-30 BILLION MARKET FOR CAPITAL EQUIPMENT, THE SUPPORT AVAILABLE TO U.S. EXPORTERS IS EXTREMELY LIMITED AND THAT SEGMENT OF THE MARKET WHERE U.S. PARTICIPATION IS POSSIBLE (WHERE SALES ARE BASED ON INTERNATIONAL COMPETITIVE BIDDING) HAS SHRUNK SUBSTANTIALLY.

### TABLE III

### LONG TERM OFFICIAL EXPORT CREDITS AND TIED AID FOR CAPITAL PROJECTS
1982, 1984, 1986, 1987 AND 1988

(U.S. DOLLARS, BILLIONS)

| | 1982 | 1984 | 1986 | 1987 | 1988 |
|---|---|---|---|---|---|
| **Unadjusted for Mixed Credits** | | | | | |
| Long Terms Official Export Credits | | | | | |
| All OECD Credits | 20.7 | 11.5 | 9.4 | 8.2 | 12.7 |
| U.S. Credits | 2.2 | 1.6 | 1.4 | 1.0 | 0.7 |
| Bilateral ODA for Capital Projects | | | | | |
| All OECD Assistance | 4.8 | 6.9 | 5.5 | 9.0 | 9.4 |
| U.S. Assistance | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 |
| **Adjusted for Mixed Credits*** | | | | | |
| Long Term Official Export Credits at Normal Terms | | | | | |
| All OECD Credits | 16.1 | 9.0 | 7.4 | 6.4 | 9.7 |
| U.S. Assistance | 2.2 | 0.3 | 1.4 | 1.0 | 0.7 |
| Tied Aid, including Mixed Credits | | | | | |
| All OECD Assistance | 9.4 | 9.4 | 7.5 | 10.8 | 12.4 |
| U.S. Assistance | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 |

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* The adjusted figures shift the long term official credit portion of a mixed credit to the mixed credit category, reflecting more accurately the relationship between long term credits at normal terms and tied aid credits.

THE GROWTH IN TIED AID DURING THE 1980s OBVIOUSLY HAS PLACED SIGNIFICANT PRESSURES ON U.S. EXPORTERS AND ADVERSELY HAS AFFECTED THE U.S. ECONOMY. THE IMPACT OF TIED AID COMPETITION IS OBVIOUS IN SEVERAL AREAS. FIRST, OUR LOSSESS IN EXPORTS HAVE BEEN ENORMOUS. THE EXIMBANK STUDY ON TIED AID ESTIMATES THAT WE HAVE LOST BETWEEN $400 - $800 MILLION IN EXPORTS ANNUALLY BECAUSE OF EXPORT SUBSIDIES. THE EXIMBANK'S FIGURES ARE INTENTIONALLY CONSERVATIVE AND ARE ONLY A PARTIAL REPRESENTATION OF TIED AID CREDIT ACTIVITY. THE ANALYSIS FOCUSES ON ONLY SIX DONOR COUNTRIES, EXCLUDING 25 PERCENT OF TOTAL TIED AID CREDIT ACTIVITY. ONLY FIVE INDUSTRIES IN THE CAPITAL GOODS SECTOR ARE INCLUDED IN THE ANALYSIS, AND THE REPORT EXCLUDES IN ITS CALCULATIONS THE LONG TERM LOAN PORTION OF A MIXED CREDIT TRANSACTION. BUILDING ON THE EXIMBANK DATA, WE HAVE DEVELOPED ESTIMATES WHICH PLACE THE ANNUAL LOSS IN THE RANGE OF $2.4 TO $4.8 BILLION PER YEAR.

SECOND, OUR COMPANIES ARE COMPLETELY SHUT OUT OF MANY IMPORTANT MARKETS. ALTHOUGH THE EXIMBANK REPORT ESTIMATES ON TIED AID ACTIVITY ARE CONSERVATIVE, THEY NEVERTHELESS MAKE THIS POINT. THE REPORT CONCLUDES THAT "A FOUR TO SIX BILLION DOLLAR MARKET OF CAPITAL GOODS TRANSACTIONS IN CERTAIN LESS DEVELOPED COUNTRY MARKETS MAY REMAIN LARGELY INACCESSIBLE TO U.S. EXPORTERS." THIS FIGURE MUST BE PLACED IN THE LARGER CONTEXT OF THE POTENTIAL LDC MARKET FOR OUR "BIG TICKET" EXPORTS. U.S.

CAPITAL GOODS EXPORTS TO AFRICA, ASIA AND LATIN AMERICA ROUGHLY TOTAL $16 BILLION. WHAT THE REPORT IS REALLY SAYING IS THAT U.S. POLICIES REGARDING TIED AID DEPRIVE OUR EXPORTERS OF ACCESS TO BETWEEN 25% AND 40% OF THE LDC MARKET FOR CAPITAL EQUIPMENT.

THIRD, U.S. EXPORTERS ARE SHUT OUT OF THESE LDC MARKETS NOT JUST IN THE INITIAL BIDDING FOR OVERSEAS SALES BUT ARE EXCLUDED FROM FOLLOW-ON BUSINESS. FOR MANY CAPITAL GOODS EXPORTS THE VALUE OF FOLLOW-ON SALES CAN BE AS MUCH AS TEN TIMES THE VALUE OF THE INITIAL SALE. FOREIGN COMPETITOR GOVERNMENTS ARE USING TIED AID SUBSIDIES IN THESE LDC MARKETS FOR STRATEGIC PRODUCT/PRODUCT POSITIONING OF THEIR EXPORTERS. THE LONG-TERM COST TO U.S. EXPORTS AND TO THE COMPETITIVENESS OF THE CAPITAL EQUIPMENT SECTOR IS OF SERIOUS PROPORTONS.

FOURTH, EXPORT SALES ARE SO IMPORTANT TO THE OVERALL MANUFACTURING CAPACITY OF MANY CAPITAL EQUIPMENT INDUSTRIES THAT LOST EXPORT SALES RESULT IN SUBSTANTIAL REDUCTIONS IN INDUSTRIAL CAPACITY. FOR EXAMPLE, THE EXIMBANK REPORT'S CASE STUDY OF U.S. POWER GENERATION EXPORTS CONCLUDES THAT THE "INABILITY OF U.S. MANUFACTURERS TO MATCH TIED AID CREDIT OFFERS HAS RESULTED IN A LOSS OF SALES EQUAL TO 20-50 PERCENT OF PRODUCTION CAPACITY." THE LINKAGE BETWEEN EXPORT VOLUME AND GLOBAL COMPETITIVENESS IS CRITICAL IN A NUMBER OF INDUSTRIES INCLUDING TELECOMMUNICATIONS, TRANSPORTATION EQUIPMENT AND HEAVY EARTH MOVING EQUIPMENT. EXPORT SALES IN ALL OF THESE INDUSTRIES USUALLY DEPEND UPON TIED AID SUPPORT.

FIFTH, LOST EXPORTS ALSO REDUCE THE CAPACITY OF CAPITAL EQUIPMENT PRODUCERS TO FUND THE RESEARCH AND DEVELOPMENT NECESSARY FOR LONG-TERM GLOBAL COMPETITIVENESS. CERTAINLY THE BILLIONS OF DOLLARS IN U.S. EXPORTS LOST TO FOREIGN TIED AID CREDIT COMPETITION DURING THE 1980's HAS ERODED OUR TECHNOLOGICAL EDGE IN MANY INDUSTRIES. IT IS IMPOSSIBLE TO IMAGINE OTHERWISE.

FINALLY, BECAUSE TIED AID CREDITS ARE NOT ASSOCIATED IN THIS COUNTRY AS THEY ARE BY OUR COMPETITORS WITH LEVELS OF DOMESTIC EMPLOYMENT, WE CANNOT EASILY CALCULATE THE COST OF THESE SUBSIDIES IN TERMS OF LOST JOBS. THE ADMINISTRATION'S LONG-TERM FAILURE TO COME TO GRIPS WITH THIS PROBLEM MEANS, HOWEVER, THAT A MINIMUM OF 50,000 AMERICANS ARE LOSING THEIR JOBS EACH YEAR.

IN WORKING OUT A POLICY RESPONSE TO THE TIED AID PROBLEM, IT IS IMPORTANT TO UNDERSTAND THE RANGE OF RESOURCES THAT FOREIGN COMPETITOR GOVERNMENTS CAN BEAR TO SUPPORT ANY SPECIFIC PROJECT OFFER FOR AN LDC PROJECT. FOR EXAMPLE, IN A RECENT TENDER, A LATIN AMERICAN COUNTRY REQUESTED THAT RESPONDENTS TO A VERY LARGE PROJECT INCLUDE GRANT, CONCESSIONAL, EXPORT CREDIT AGENCY (ECA) AND CONVENTIONAL FINANCING OFFERS FOR 135% OF THE TOTAL LOCAL AND FOREIGN CURRENCY COSTS! EIGHT NON-U.S. SUPPLIERS/CONTRACTORS BID FOR THIS PROJECT. THE FINAL OFFERS, WHICH WERE REPORTED IN THE LOCAL PRESS AND CORRABORATED BY THE NFTC, ARE OUTLINED IN THE FOLLOWING TABLE.

## TABLE IV

## GRANT/MIXED CREDIT/ECA SUPPORT IN A LATIN AMERICAN INFRASTRUCTURE PROJECT (PERCENTAGE OF CONTRACT PRICE)

| | ITALY | FRANCE | CANADA |
|---|---|---|---|
| Total Domestic & Foreign Cost | 100% | 100% | 100% |
| Grants | 6% | 3% | 4% |
| Soft Loans | 33% | 25% | 19% |
| ECA Loans | 58% | 50% | 46% |
| Commercial Banks | 27% | 26% | 37% |
| Total | 124% | 104% | 106% |

THE SOFT LOANS WERE FOR 10 YEARS AT 1.75% FROM ITALY; 30 YEARS AT 2% FROM FRANCE AND 50 YEARS AT ZERO INTEREST FROM CANADA. THE ECA LOANS WERE AT O.E.C.D CONCENSUS RATES BUT FOR 12/15 YEARS AND A SIGNIFICANT PORTION OF THE FRENCH COMMERCIAL BANKING FINANCING OFFER WAS GUARANTEED BY AN EXPORT CREDIT AGENCY.

THIS EXAMPLE IS NOT GIVEN JUST TO ILLUSTRATE THE CHARACTERISTICS OF EXPORT FINANCE COMPETITION. IT IS IMPORTANT IN INDICATING THE ARRAY OF INSTITUTIONAL SUPPORT THAT CAN BE MARSHALLED BY COMPETITION TO SUPPORT AN EXPORT DEAL. BY CONTRAST, IN THE U.S. THERE IS NO SINGLE INSTITUTIONAL STRUCTURE WHICH CAN BE CONSIDERED EFFECTIVE. THE EXIMBANK IS SO

UNDER-FUNDED IT CANNOT MEET ORDINARY FINANCE REQUIREMENTS. OUR SUBSIDY FUND, OR "WAR CHEST," IS SMALL AND NEARLY USELESS BECAUSE OF LEGISLATIVE RESTRICTIONS ON ITS APPLICATION. OUR FOREIGN AID PROGRAM IS BOTH OVER-BURDENED AND INSTITUTIONALLY INCAPABLE OF ADDRESSING THE CAPITAL PROJECT NEEDS OF THE DEVELOPING WORLD. COMMERCIAL BANKS HAVE FOR THE MOST PART LEFT THE EXPORT FINANCE FIELD, BUT WOULD BE INCAPABLE IN ANY CASE OF RESPONDING TO A LONG TERM CONCESSIONAL CREDIT OFFERED AT AN EFFECTIVE ANNUAL RATE OF ONE, THREE OR EVEN FIVE PERCENT.

A CREDIBLE POLICY RESPONSE TO TIED AID MUST ATTEMPT TO MOVE FORWARD ON AS MANY OF THESE INSTITUTIONAL BASES AS POSSIBLE. AS A MATTER OF GENERAL POLICY, THE EXIMBANK MUST BE MORE COMPETITIVELY FUNDED AND GIVEN MORE FLEXIBILITY TO DIRECTLY MEET THE REALITIES OF FOREIGN COMPETITION. THE TIED AID WAR CHEST OUGHT TO BE REAUTHORIZED, BUT ONLY IF THE CURRENT STATUTE IS AMENDED IN WAYS THAT WOULD MAKE IT AN EFFECTIVE INSTRUMENT FOR COMBATING RATHER THAN REACTING TO FOREIGN TIED AID OFFERS. THE OPERATION OF THE WAR CHEST WOULD BE GUIDED BY BROAD DEVELOPMENT GUIDELINES AND APPROPRIATE CONSULTATION WITH AID. SINCE WE ARE OPPOSED TO ESTABLISHMENT OF A NEW ENTITLEMENT PROGRAM FOR EXPORTERS, THE REAUTHORIZED WAR CHEST SHOULD BE LINKED TO A MULTILATERAL NEGOTIATING STRATEGY. THE FUND WOULD TERMINATE UPON THE CONCLUSION OF A SUCCESSFUL INTERNATIONAL AGREEMENT ON TIED AID.

WE WOULD BE KIDDING OURSELVES IF WE CONCLUDED THAT A WAR CHEST OF $100 MILLION, OR $110 MILLION, SENDS A CREDIBLE MESSAGE TO OTHER GOVERNMENTS THAT THE U.S. IS SERIOUS ABOUT ELIMINATING TIED AID PRACTICES WHICH ARE COMMERCIALLY MOTIVATED -- OR THAT THE AMOUNT COMES CLOSE TO SATISFYING THE REQUIREMENTS OF U.S. EXPORTERS ATTEMPTING TO COMBAT BY FOREIGN TIED AID COMPETITION. A PROGRAM OF $200 MILLION IS THE MINIMUM FOR AN ACCEPTABLE IMPACT. COMBINED WITH THE NECESSARY LONG TERM CREDITS, THE EXIMBANK COULD THEN OFFER A FUNDING MIX OF APPROXIMATELY $500 MILLION ANNUALLY FOR TIED AID. IF THE ADMINISTRATION IS SERIOUS ABOUT GIVING HIGHER PRIORITY TO U.S. GLOBAL COMPETITIVENESS, A CONCENTRATED EFFORT MUST BE MADE TO TRANSFER SUFFICIENT RESOURCES TO A REAUTHORIZED WAR CHEST AND TO THE DIRECT CREDIT PROGRAM WHICH SUPPORTS IT.

ALTHOUGH U.S.A.I.D. PROGRAMS ARE NOT WITHIN THE JURISDICTION OF THIS COMMITTEE, A CAPITAL PROJECTS PROGRAM SHOULD BE REESTABLISHED WITHIN THAT AGENCY. THIS MOVE MAKES SENSE IN BOTH ECONOMIC DEVELOPMENT AND TRADE COMPETITIVE TERMS. THE PROGRAM WOULD OPERATE ON SOUND DEVELOPMENT CRITERIA AND WOULD SUPPORT MULTILATERAL TIED AID CREDIT NEGOTIATIONS.

MULTILATERAL NEGOTIATIONS SHOULD BE AIMED AT AN AGREEMENT AMONG OUR TRADING PARTNERS THAT CAPITAL PROJECT ASSISTANCE BE OFFERED ON ECONOMIC DEVELOPMENT GROUNDS AND THAT COMMERCIALLY MOTIVATED MIXED CREDIT SUPPORT BE CURTAILED. WE COULD ENUMERATE NEGOTIATING OBJECTIVES AND A LIST OF SUPPORTING STEPS THAT MIGHT

BE FOLLOWED. THE MOST IMPORTANT POINT, HOWEVER, IS THAT WE ARE THE ODD-MAN-OUT IN THE TIED AID CREDIT GAME AND CLEARLY THE MOST HARMED IN COMPETITIVE TERMS. CONSEQUENTLY, TIED AID NEGOTIATIONS WILL REQUIRE A HIGH PRIORITY WITHIN THE U.S. GOVERNMENT AND A COMMITMENT OF RESOURCES TO ADEQUATELY SUPPORT A LENGTHY AND EXTREMELY DIFFICULT PROCESS.

THE NFTC CONSIDERS THE ELIMINATION OF FOREIGN SUBSIDIES IN EXPORTS AN IMPORTANT ELEMENT OF OUR NATIONAL TRADE POLICY. WE HOPE TO WORK ACTIVELY WITH THIS COMMITTEE AND OTHER POLICY MAKERS TROUBLED BY OUR CURRENT TRADE POSTURE TOWARD THAT GOAL.

THANK YOU.

Senator SARBANES. Thank you, sir. That was very helpful testimony.

Mr. Tucker.

## STATEMENT OF STUART K. TUCKER, FELLOW, OVERSEAS DEVELOPMENT COUNCIL, WASHINGTON, DC

Mr. TUCKER. Thank you, Mr. Chairman.

As we have had discussion of two other biblical figures earlier in the meeting, Peter and Paul, I think I feel somewhat like John the Baptist at this hearing, for I think I will be saying some controversial and quite minority-view-type statements here.

In a hearing about a War Chest, it seems natural to use military terms. But let me remind the committee, the chairman, and all the participants, that this is fundamentally an economic issue, and primarily an aid issue, although it has a significant trade component related to it.

Now, in dealing on economic terms, we do not want to be talking about offensive strikes to seize the goods markets, or what have you. What we want to be talking about is overall national welfare, the good of development in developing countries, the benefits of our own constituencies, and the companies that keep the vitality of this nation going in the long run.

Looking at it from all these points of view, we see that the mixed credit program can have basically three objectives: One is to further our commercial gain. Another is to further the development in the recipient country, which, after all, is receiving a grant of some sort. A third is to promote our negotiations objectives.

My testimony, which I ask to be submitted into the record, basically points out that these three objectives cannot be pursued simultaneously with a War Chest; that the War Chest can do one, maybe two of them, but certainly not all three. In many ways, it is only going to be effective if it is targeted for one of those goals.

Let me review these goals, and what they mean. On the commercial gain side, what we have is nearly a whole decade here, the 1980's, in which developing countries have been facing a debt crisis of tremendous magnitude, and a banking sector that is unwilling to continue to finance even short-term trade transactions. My testimony provides data showing that private export credits have dropped dramatically during the period.

So the question is, how do we support our commercial interests in such a climate, with developing countries that by and large are not capable of paying commercial terms? Of course, the major problem is alleviating the debt crisis; but then, there is the other problem of finding a way to support the normal transactions of trade. Certainly, the private sector has failed us during the 1980's. Therefore, there is a role for the Government to play.

As Senator Heinz has pointed out, that role has been greatly diminished in the 1980's on the U.S. side. The Export-Import Bank in the early 1980's was providing about $5 billion of direct credits. In the late 1980's, it is only about 10 percent as much. A 90 percent drop is totally unsupportable, if we are trying with the Export-Import Bank to support our commercial interests in the Third World.

### MIXED CREDIT PROGRAM IS COSTLY

So certainly, the direct credit program is one aspect of supporting our commercial gain. The question is: Is the mixed credit approach the best way to do it? The mixed credits involve a substantial amount of financial incentive on the grant side, which in fact distorts the interests of other people.

It also is very costly. I think the Congress has always been resistant to having a substantial mixed credit program, because it is very costly and very inefficient in the long run for supporting our commercial interests.

The second goal of a mixed credit program is development. Clearly, the grant element is becoming quite large in all of these new mixed credit offers that we are seeing. That reflects some of our negotiating success. As Dallara had suggested earlier, there are not very many cases to which we can point—certainly very weak evidence—that other countries are violating the terms of the 1987 agreement.

What we have seen is a dramatic rise in the concession element of these mixed credits. The gentlemen here have aptly pointed out that mixed credits as a whole have risen dramatically, but the grant element has risen dramatically within that.

So I would like to point out from the development point of view, what does that really mean? What are our competitors thinking when they are handing out so much cash? We went into the negotiations thinking that in fact they would find that too costly and they would cease doing it. As has been pointed out, they have not ceased doing it.

If you approach the Japanese or the French and you talk to them about this, you realize that they have a fundamentally different view about what they are doing. They see their first priority is aid—that is—development. Commercial gain is a second priority in what they are doing. I admit there is a commercial gain they are getting out of their activities, but their main purpose is to support the development goals.

Their development goal is quite different from the U.S. Agency For International Development's approach, but it is still a legitimate development goal that they are pursuing. Now we can go to Paris and talk to them about that, and in the long run that, I think, is what the Treasury Department is suggesting we do. We take the capital goods issue, we isolate it; we go and talk about how we can make aid programs better and donor coordination work. That is a valid negotiating purpose.

But to question another country's development priorities I think is a big problem. If someone came to us and said, "Basic human needs? What are you talking about? That is not what we are doing, why should you do it?" I think we would reject them out of hand; because clearly we have a substantial interest in supporting basic human needs. Our foreign aid program is totally oriented around that, and it ought to be continued as long as we have a bipartisan consensus built around that, which I think we have demonstrated over the years does exist.

Therefore, capital goods is a competing priority with our aid program. It, however, is the main priority for other countries. That fundamentally is where the problem lies. Their development goals involve mixed credits, and ours do not.

### NEGOTIATIONS

The third priority, of course, is negotiations. Now, we have gone into the negotiations with the attitude that they ought to be a little more like us. They ought to stop giving out concessional mixed credits at low levels, they should make a higher grant element when they do, and hopefully they will realize that is very expensive and they will stop doing it.

In some sense, they have agreed with the negotiation priority that we have had. They have raised the grant element from 25 percent to 35 percent, and they are going in that direction, probably with an open mind. Any further, maybe 50 percent, as was suggested earlier in the remarks, Mr. Chairman, is going to be tough to negotiate. That is clear. But it is a valid U.S. goal.

The question, therefore, is, if our competitors see this as an aid issue, what is our negotiating leverage? Can we hand our negotiators a hammer, as has been suggested, to beat them over the head and get them to change their practices? Yes, if the hammer is big enough. A hundred million dollars is not big enough.

I wonder if $1 billion is big enough. I even wonder if $3 billion is big enough. In clear statement of fact, our competitors on the trade side, using mixed credits, see this as an aid priority. Unless we get donor coordination to resolve some of these problems, they are not going to budge at the negotiating table because we go around brandishing a War Chest, especially if it is only $100 million.

I do not think we can justify an expensive War Chest, so I am here to say that we do not need a War Chest. In fact, our negotiation experience proves that is true. In the past, the War Chest was not what got us the agreement of 1987; it was in fact the recognition by our partners that this was a legitimate reason to change their policies. We have in the last few years gotten Japan to agree that they ought to be putting more money into the development field, and they ought to be recognizing the concerns on the trade side as they do it.

I think over the next few years we are going to see them continue to bend towards the U.S. position, which is that they should be untying their aid practices, and they should be giving more money, and in the long run therefore I think the mixed credit problem can be negotiated without a hammer, and certainly without the kind of hammer that we might need if in fact they were resistant.

My recommendations, basically, therefore, fall into three categories. The War Chest is either too small, or too big. It is too big, because it is money that is not going to do any good; therefore, let's not spend it. It is too small, because it is not going to change practices overseas.

However, we do need money for the direct credit program of ExIm Bank. It is incredibly small right now, and we have legitimate commercial interests that our private banking sector is not supporting.

Second, if in fact we do want to support capital goods projects through our aid program, our aid program has to be increased. We cannot rob the basic human needs priorities in order to support export credits for capital goods industries.

That basically is my testimony. I would be happy to answer questions, especially regarding the interest subsidy issue, because I think that our government officials did not quite cover one aspect of our obligations internationally.

Senator **Sarbanes**. Why don't you touch on that?

Mr. **Tucker**. Pardon?

Senator **Sarbanes**. Why don't you touch on that, instead of awaiting a question.

Mr. **Tucker**. The interest matching program that had been proposed in the past ran into two basic problems. First of all, the private export creditors, the banks in the United States, did not like the way it was proposed to operate.

The second problem, however, is that we have an obligation under the OECD mixed credit Arrangement that we not subsidize on the interest side. In fact, we have a very narrow band in which our interest rates can float. Therefore, we are getting into some dangerous ground if we start breaking the agreement by subsidizing the interest, rather than giving grants.

That is the basic problem. We should retain our commitments within OECD, if we are legitimately trying to raise the grant element in the long run and support over overall interests in cutting back what in the past certainly were more commercially oriented mixed credit offers.

[The complete prepared statement of Stuart K. Tucker follows:]

OVERSEAS DEVELOPMENT COUNCIL
1717 Massachusetts Ave., N.W. / Washington, D.C. 20036 / (202) 234-8701

# "Tied Aid Credits in U.S. Trade and Development Policy"

STATEMENT OF

Stuart K. Tucker

Fellow
Overseas Development Council

before the

Subcommittee on International Finance
and Monetary Policy

of the

Committee on Banking, Housing, and Urban Affairs
U.S. Senate

13 September 1989

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Mr. Chairman and Members of the subcommittee, before reviewing the role played by mixed credits (also known as tied aid) in world trade and development, let me state that these thoughts are my own and are not meant to represent the views of the staff, board, or council of the Overseas Development Council. My testimony is divided into five sections. Section I reviews the importance of growth in developing countries. Section II summarizes the role of export credits in today's economy. Section III comments upon the specific uses of mixed credits. Section IV recaps Eximbank's financial activities in the 1980s. Section V provides the implications and recommendations that flow from the analyses of Sections I, II, III, and IV.

## I. THE IMPORTANCE OF DEVELOPING COUNTRIES IN U.S. TRADE

For the remainder of this century and beyond, the economic welfare of the United States will be increasingly linked to developments in the global economy, especially in the developing countries which are the most dynamic "players" in the world economy. Policies designed to recapture competitiveness and increase U.S. exports, jobs, and economic growth are going to have to take into account growth, or the lack of it, not only in other industrial countries but also in the developing countries. Heretofore, most analysts have largely ignored the role that the developing countries play in the U.S. economy, and there is little understanding of the extent to which resumed growth in the developing countries could create significant export opportunities for the United States in the 1990s and thereby improve its international economic position.

In the last decade, a number of developing countries became major U.S. export markets as well as important U.S. competitors. The emergence of the developing countries as important participants in the international economy occurred as economic linkages between all countries grew stronger. For the United States, this increased interdependence was a new development. U.S. imports and exports to the developing countries grew at 6-7 per cent a year, much more rapidly than exports to traditional U.S. trading partners in the industrial world. By 1981, the developing countries were purchasing 41 percent of U.S. exports, a greater share than Europe and Japan combined.

The experience of the last decade and a half demonstrated not only the benefits but also the risks of the new importance of the developing countries to the U.S. economy, however. With the onset of global recession in the early 1980s, growth rates in the industrial world fell, interest rates soared, and developing-country growth came to a halt.

The employment effects of international trade have become important political issues because of the secular rise in unemployment during the 1970s and 1980s. This was underscored by the increased share of Third World exports bought by the United States during this period. However, careful analysis indicates that, on balance, North-South trade has resulted in net job gains for the North.[1] U.S. industries found large gains in some high-value-added sectors and losses in low-value-added sectors. Most of the U.S. job losses linked to trade with the developing nations have been due to a loss of exports, not to an inordinate surge in imports.[2]

U.S. trade problems with the developing countries are more the result of the current Third World debt predicament and weakened developing-country import capacity than of either unfair practices or of any fundamental (non-exchange rate-related) decline in U.S. competitiveness. The key element in solving U.S. trade balance problems is to support growth in these developing countries.[3]

## II. THE ROLE OF U.S. GOVERNMENT EXPORT CREDITS

During the 1980s, global trade has been jarred by dramatic shifts in financial flows. The Third World debt crisis has fundamentally altered the world of trade by damaging income growth and dampening demand for exports, by forcing Third World export promotion and import compression, and by throwing capital spending plans into disarray. The net result has been a world plagued by budget and trade imbalances of enormous magnitudes, and the ever-present threat of renewed recession.

The overlooked story amid this trauma has been the drying up of private export credits. While debt rescheduling captures the media headlines, a parallel retrenchment by commercial banks is underway. Industrial-country private, commercial, short- and medium-term credits to facilitate trade transactions with the Third World dropped from $29.4 billion in 1981 to $13.8 billion in 1986. Net disbursements of such credits went from $10.5 billion in 1981 to **negative** $1.6 billion in 1986.[4] That is to say, industrial-country commercial banks received more in repayments of past credits than they lent in 1986. In short, private export credits are not available to facilitate expansion of imports by developing countries in the late 1980s.

When the private sector fails to perform a set of activities necessary to the proper function of free markets, the government has a legitimate responsibility to correct these market failures by intervening with an appropriate government-run response. Indeed, this was the philosophy that led to the creation of the Export-Import Bank of the United States (Eximbank) in the 1930s.[5]

The current activities of Eximbank are geared for fulfilling three roles: promoting U.S. trade, facilitating Third World development, and enhancing the U.S. position in bilateral and multilateral trade negotiations.[6]

**U.S. Trade Promotion.** The fundamental purpose of official export credits is to finance activities that the private sector considers too risky or insufficiently profitable. Over the years, as industrial-country buyers gained strength and creditworthiness, Eximbank's role has shifted toward finance for U.S. exports to developing countries. Furthermore, Eximbank, as a public-sector institution, is most useful when it steps into the market more heavily during economic slumps. Thus, Eximbank should play a counter-cyclical role by promoting U.S. exports at precisely the time when business activity is slow.

**Third World Development.** Third World buyers who have difficulty finding private capital receive an economic boost from the provision of official export credits and guarantees. In addition to the benefits of access to such credit, lower-income developing countries receive the added assistance of credit at lower interest rates than commercially available even to more creditworthy buyers. The OECD Arrangement on export credits has established separate interest rate categories to allow agencies in industrial countries to provide this low-cost finance according to the level of development of the recipient. Finally, the tied aid program throws grant money into the deal to make the financed project even more affordable for the lower-income developing countries.

**Trade Negotiations**. In recent years, Eximbank has been called upon to serve as a weapon for trade negotiators. Eximbank always had the implicit role of "leveling the playing field" so that purchasing decisions were made on the basis of product competitiveness rather than on the basis of unequal financing terms. In the 1980s, Eximbank activities followed two new paths. First, the increasing use of tied aid by other countries raised worries that this "aid" was not being spent for development purposes but for commercial gain. Hence, the current "war chest" is meant to counter-balance subsidized financing. This role will be more fully discussed in section III below.

Second, Eximbank has been called upon to provide subsidized financing to sales of U.S. goods in U.S. markets in cases where foreign competition for the sale is subsidized. Primarily aimed at Japanese and Brazilian goods, this policy is intended to bolster U.S. bilateral trade negotiations with the hope that subsidies and trade barriers can be reduced in these countries.

## III. THE USE OF THE MIXED CREDITS "WAR CHEST"

In creating a "war chest" of funds to finance mixed credits, the hope was that this pool of money would make the United States able to match such subsidies by other countries and cause them either to stop using the aid subsidies for commercial gains or to spend even more aid, thus making it overly costly to do such for commercial gain (hence, it might be safe to assume that the money is being spent on a legitimate development aid project).

In the ideal world, Eximbank would be able to use these funds to win the "competition" for providing the best credit terms. This combined with a competitive product would yield an American sale. Other countries would then have to decide whether to up the ante by giving larger subsidies in their financing bids or to cease offering such large subsidies. If the other countries backed away from larger subsidies, then the war chest served its purpose of deterring unfair credit deals for commercial gain. On the other hand, if the other countries raised the ante, then the United States would have to raise its subsidies or risk losing the sales. The gamble being played with a war chest is that other countries would not raise the ante because of the high costs incurred. The incentive, therefore, for the other countries to back down resides solely in the size of the U.S. war chest. The smaller the size of the war chest, the less incentive there is to back down.

**The Developmental Impact.** Unfortunately, mixed credit sales have effects other than those upon trade negotiations. The use of a subsidy to make a commercial sale attractive is, in effect, an offer to a country to make a decision it might not otherwise make. In short, the aid can be trade-distorting. By paying the buyers to buy a different product than they would have, the credit agency has twisted the preferences of the buyers. If those buyers, without the attraction of the mixed credit, were making economically rationale choices, then the mixed credit could be luring the buyers into a bad decision. In the end, an altered choice may be the wrong choice from the perspective of the buying country's development interest.

On the other hand, if the buyers would have bought the product regardless of the financing, then the mixed credit is not trade-distorting and is a simple transfer of money to the buyers. In short, under this circumstance, the mixed credit plays a positive developmental role. Of course, if this is the case, then the trade negotiation aspect of the credit is defeated, because the credit agency did not have to counterbalance the foreign competitor's offer to get the sale.

Thus, a mixed credit only serves a developmental role if it is not trade-distorting and is, consequently, not serving a trade negotiation role. Similarly, a mixed credit only serves as a bargaining tool in trade when it distorts trade and is, therefore, playing a negative role in the development process. The central determinant is whether the buyers will change their decision based upon the mixed credit offer.

Since this is likely to happen more often when the subsidy element is high, a fairly straight-forward conclusion is the following. The higher the level of the subsidy is in a commercially-oriented mixed credit, the less positive (or more negative) the role the credit plays in the development process. Yet, a low level of subsidy is not as likely to succeed in accomplishing the trade negotiation objective. In sum, the mixed credit is a uni-dimensional policy tool which can only achieve one of these two objectives.

**World Use of Mixed Credits.** The United States has been concerned that the high level of the subsidy inherent in foreign mixed credit offers is distorting trade (and hurting U.S. export sales). The grant portion of mixed credit offers by other countries is very high. In fact, the logic of commercial gain suggests that the grant element is often too high--more than enough to accomplish the commercial sale, thus, wasting that portion of the subsidy that did not matter to the buyer.

The explanation for this is two-fold. First, we live in a world with imperfect flows of information and the foreign credit agencies are overly exuberant in securing the sale. Second, many of these agencies believe they are transferring wealth to the recipient country—in other words, the mixed credits are a form of aid. This second argument only holds water if these agencies have taken special care to make certain that the sale was not distorting trade and was developmentally correct, regardless of the financial terms. It can be argued that, indeed, these agencies will have developmental interests rather than commercial concerns at the forefront of their decisions to offer mixed credits, if those credits are so costly as to not be justified by the marginal commercial gain obtained.

It is this final logic which has driven the historic U.S. bargaining position on mixed credits. The United States has tried to raise the minimum grant element allowable for mixed credit offers by OECD countries, so that the budgetary impact would be too large to be justifiable on commercial grounds. In the end, such mixed credits would only be offered as truly useful developmental assistance. Such credits, then, should be screened by the offering agency for effectiveness in the same manner as official development assistance.

**The Mixed Credit Agreement.** The 1987 OECD agreement to raise the minimum level of the subsidy element in mixed credit offers represents a general success for the U.S. trade-negotiating strategy on mixed credits. The year 1987 brought swift changes to the mixed credit practices of two of our chief export credit rivals, France and Japan.[7] Although both offered more mixed credits in 1987 than in 1986, the grant element rose dramatically. French mixed credit cases with a grant element greater than the newly established 30 per cent minimum rose from 15 per cent to 54 per cent. While the French have to change more to be in compliance with the agreement, they have shown a ready willingness to change policy in the right direction. The Japanese ceased completely financing with grant elements below 30 per cent, confirming their long-held position that their mixed credits are offered for development purposes, not commercial gain.

## IV. REVIEW OF EXIMBANK FINANCES IN THE 1980s

During the period 1981-1988, total Eximbank authorizations fell from $12.9 billion to $6.4 billion. During this time, Eximbank direct lending fell dramatically—from $5.0 billion to $465 million (a 91% drop). Insurance and guarantees also declined, although less dramatically. The net result of this drop in direct lending has not only been a drop in the value of U.S. export sales supported by Eximbank but also a decline in the effectiveness of U.S. authorizations. Whereas overall authorizations fell more than 50%, the decline in Eximbank-supported U.S. exports was 65%—from $18.6 billion in 1981 to $6.5 billion in 1988. Thus, in 1981 one dollar of Eximbank authorizations supported nearly $1.50 in U.S. exports; the ratio in 1986 is barely above one-for-one.

The decline of direct lending has been particularly damaging for U.S. trade with low-income and lower middle-income developing countries. These countries typically are less creditworthy. Private lenders are unwilling to lend to them, even with insurance and guarantees. In effect, the direct lending program is the only sure way Eximbank can provide aid to trade with these poorer countries. Thus, the virtual disappearance of the direct lending program has reduced the developmental role of Eximbank.

Relative to the demise of U.S. direct lending, U.S. mixed credit funds are extremely small. During 1987 and 1988, less than $86 million were spent in war chest actions.[8] Thus, while the U.S. Eximbank was reducing its direct credits by roughly $4.6 billion (1981 compared to 1988), it was wielding a minuscule mixed credit fund as its stick in trade negotiations.

This drop in direct lending has led to a decline in Eximbank's worldwide exposure from $38.4 billion in 1981 to $27.4 billion in 1988. However, the reliability of Eximbank's outstanding portfolio has been severely damaged over the same period. Delinquent loans have risen from $888 million to $2.7 billion. The ratio of delinquent loans compared to loans receivable has changed from 5.6 per cent to 27.4 per cent.

The rising cost of borrowing in the 1982-85 period out-paced Eximbank revenue increases and Eximbank's net income has been negative since the beginning of 1982. Eximbank lost an average of $445 million annually during 1987-88. As a result of this lengthy period of losses, in 1988 Eximbank used up its last reserves (which were $2.2 billion in 1981) and began to eat into its capital. Eximbank's staff does not expect net income to be positive until well into the 1990s.[9]

This brief review of Eximbank lending shows that the institution is playing a smaller role in U.S. trade during a period in which it should be more active. The Eximbank is facing a serious capital crunch that only serves to impair its ability to play a positive role in the future. Though not a major holder of delinquent debt claims, the official nature of Eximbank makes its actions on delinquent loans highly political. Thus, the U.S. Congress must seriously weigh its actions with regard to Eximbank's future in the world trade and financial system. Eximbank is in danger of falling into obscurity and irrelevance.

## V. CONCLUSIONS AND RECOMMENDATIONS

**We won without the war chest.** The United States achieved its goal of reducing the commercial use of mixed credits. Mixed credits in the future will be given largely for development purposes. This was achieved despite the fact that U.S. mixed credit funds have been insubstantial in size compared to other countries and sparingly used by Eximbank. It is stretching credibility to portray the war chest as the cause of the 1987 OECD agreement on mixed credits.

**Future mixed credits will not be a commercial threat.** The agreement to raise the grant element has raised the cost of using mixed credits. Industrial countries now find the use of mixed credits to be so high that the use of mixed credits for commercial purposes will be too expensive to be justified. Future mixed credits will be issued with the best interests of the recipient in mind. In short, the tied aid will be used for development purposes.

**The war chest is not well-suited for aiding Third World development.** The war chest is administered by an agency unfamiliar with the development needs of recipients.

**The war chest can only be justified on the grounds that it supports U.S. negotiating objectives.** A renewal of the war chest is unnecessary in light of the state of current negotiations. It is too soon to push hard for negotiations to further increase the minimum grant element for mixed credits. Our trading partners advocate giving the 1987 agreement a chance to work. With no negotiations likely, the war chest cannot serve to support U.S. negotiating strategy.

**Too much attention has been devoted to the U.S. mixed credit war chest and not enough attention has gone to overall trade promotion.** The amount of funding and the achievements of the war chest are extremely small compared to overall U.S. trade flows and credits to support such flows.

**Eximbank's financial situation is weak and this is damaging to U.S. exports.** The ability of Eximbank to support U.S. export interests is severely damaged by low authorization levels for direct credits, by the rising level of delinquent loans, and the declining reserve situation. U.S. exporters are being hurt by the confluence of Eximbank's financial constraints and the Third World debt crisis (which has cut into private financing). Eximbank has been reducing its activities throughout the 1980s when it should be increasing its support for U.S. exports. Typical

Third World buyers cannot pay market interest rates for export credits. The debt crisis continues to constrain the level of imports by developing countries. With much of their budgets stretched to cover payments on past debt, developing countries cannot enter the private market to finance imports.

## Recommendations.

In sum, the war chest is bad for development, is too small to have any effect on trade negotiations, and is an inefficient (and overly costly) tool for promoting U.S. exports. I have to conclude with this challenge: does it make sense for the U.S. Congress, in a year of budgetary stringency, to pay foreign buyers to buy goods that they either would have bought anyway or should not buy, and to justify this action on the grounds that the war chest supports negotiations that are not taking place?

1. Do away with the war chest without delay.

2. If it is politically impossible to do away with the war chest, retain the primary role of the U.S. Treasury Department, since it is in the best position to use the war chest to support U.S. negotiating objectives (which is the only reason to have such a policy tool).

3. Recapitalize Eximbank to allow it more freedom of manuever in handling bad debts and to encourage continued operation at low interest rates to borrowers.

4. Increase dramatically the authorization ceiling for the Eximbank direct lending program to better promote U.S. exports as well as provide much needed financing to lower-income countries.

5. Provide new funds for A.I.D. to use for development purposes; most of this aid will be spent on U.S. goods anyway and the growth impact will further help U.S. trade.

NOTES

1. United Nations Industrial Development Organization, Industry and Development: Global Report 1986.

2. See Stuart K. Tucker, "U.S.-Third World Trade Deficit: Going After the Causes", ODC Policy Focus No. 7, 1985 (Overseas Development Council, 1985) for an analysis of the causes of the U.S. trade deficit.

3. For an analysis of the potential of exports to developing countries to reduce the U.S. trade deficit, see Growth, Exports, & Jobs in a Changing World Economy: Agenda 1988 edited by John W. Sewell and Stuart K. Tucker (Transaction Books, New Brunswick, 1988).

4. Organization for Economic Cooperation and Development (DAC), Development Cooperation, 1988 Report (Paris: 1988), p. 246; Development Cooperation, 1985 Report (Paris: 1985), p. 330.

5. See Richard E. Feinberg, Subsidizing Success: The Export-Import Bank in the U.S. Economy (Cambridge: Cambridge University Press, 1982) for more information on the economic logic behind the creation of Eximbank.

6. See The Export-Import Bank at Fifty edited by Rita M. Rodriguez (Lexington Books, 1987) for evaluations of Eximbank's activities as of the mid-1980s, including a number of analyses on the issue of mixed credits. In that volume, "Export Credits in U.S. Trade, Development, and Industrial Policy" by Richard E. Feinberg and Stuart K. Tucker discusses an additional role—that of promoting U.S. industrial policy.

7. Statement of John A. Bohn, Jr. before the House Banking Committee, February 25, 1988.

8. Statement of John A. Bohn, Jr. before the House Banking Committee, February 25, 1988.

9. Statement of John A. Bohn, Jr. before the House Banking Committee, February 25, 1988.

Senator SARBANES. Well, gentlemen, thank all of you.

Mr. Tucker, on what basis do you conclude that the primary objective of these other OECD countries is development, and not commercial advantage?

Mr. TUCKER. There are a number of ways to view that. On the first level, we have gotten testimony by the people themselves.

Senator SARBANES. They told you that?

Mr. TUCKER. They have not told me directly.

Senator SARBANES. They told someone else?

Mr. TUCKER. They have told people about their aid priorities.

Senator SARBANES. Okay.

Mr. TUCKER. That is of record.

Second, if you look at the budgetary implications of what they are doing, they are robbing their own taxpayers to pay developing countries to buy their own goods. There are some market share implications, I realize; but by and large, it is a very expensive practice.

Japan, when the arrangement of 1987 was signed, raised their concessional level to meet those objectives.

Senator SARBANES. Well, on what basis do you take that view? Have you done an analysis that shows that when you work it all out it is a very expensive practice for them?

Mr. TUCKER. I have not done a direct analysis, but it is simple math. They are giving more now than they were before, and the grant element is now 35 percent instead of 25 percent, we are talking more than 100 percent jump in their aid budget. It is directly out of their aid budget that they finance this.

It is clearly a large amount of money.

Senator SARBANES. How is that a 100 percent jump in their aid budget? I do not follow that math. If they have to go from 25 percent to 35 percent——

Mr. TUCKER. That represents a 40 percent jump right there, and our gentlemen have already explained that there has been a dramatic increase in overall amounts of mixed credit offers.

Senator SARBANES. Not on a magnitude of 100 percent, I do not think.

Mr. TUCKER. Oh, I think in the 1980's we have seen several 100 percent growth by some countries—no?

Mr. KITTREDGE. Well, no, it has not been—it has been almost double. Since 1982, it would show—no, it's 9.4 to 12.4 from 1982 to 1988.

Senator SARBANES. That is what I thought.

Now, what about the benefits they get from it? Did you cost those out?

Mr. TUCKER. The benefits are clear. They are winning the sales. I would point out that the benefits——

Senator SARBANES. They are not only winning the sale on which they use the tied credit, but they then win a lot of subsequent sales. Have you factored that in? That is the important point here. You cannot take this and look only at the particular sale in which the underwrite is used to gain it. You have to somehow factor in what then follows on, in terms of the position they establish then for subsequent sales and their subsequent involvement in that country.

Mr. TUCKER. That is certainly a factor to consider. But let us consider the dynamics of the market we are dealing with. Many of these products are extremely large: elements of airports, elements of railroad systems, large power generating equipment. In many ways, these are not going to be replicated over the long period. There may be one more sale in the country involved over a ten-year period.

Second, any aid amount of money that is spent is going to generate a long-term relationship. The United States, with its $15 billion aid budget, is generating similar contacts on the food processing side, the health and population services side, the managerial system side, the computer sciences side. We are doing the exact same thing, but not in capital goods; rather, in basic human needs related product services.

Senator SARBANES. Well, on what other basis do you reach this conclusion? Thus far, I do not find a very solid basis for it; but I want to give you a chance.

Mr. TUCKER. As I mentioned, we have the first two, which is their own testimony and the basic mathematics of the dollars involved. The third point is that the report submitted by ExIm Bank in April did contain elements of the concerns of other countries. Essentially, the French were saying, "Hey, we cannot support this much longer. We cannot increase at the same rates we have been increasing in the past." They recognize it is a very big budgetary restraint.

Senator SARBANES. Well, how would you see competition taking place in this field? If you are going to, in effect, move off of price, quality, and service, and allow a government inter-mix into it, how then do you control that? What is the basis on which the competition takes place?

What is the fallacy in the argument that says: Look, competition ought to be on economic terms. Let us have a straight-out competition on those terms. Now, if you want to provide aid, do that through some other channel which is clearly an aid program; but to the extent that you are inter-mixing the aid program and what would ordinarily be a commercial relationship, you have no standards by which to judge the competition.

Mr. TUCKER. That is why it is fundamentally important that, in the allocation of mixed credits, it be development-oriented thinking that guides the practice. I think it is something that we should be careful about here. Do not give ExIm Bank the role of being a development agency. We already have one that does that sort of thing. The Japanese have similar ties on their aid side to their mixed credit practices.

The basic problem is to be sure that the country that is buying does not distort its preferences to buy something that it ought not to buy. If it is in fact buying something that it was not going to buy in the first place, that is inefficient, and is robbing its own national wealth simply on the basis of the credit terms.

I agree; that is improper, and we should be fighting against that. That would be the primary objective of any negotiations, as has been suggested by the Treasury Department, to move the capital goods issue into an untied basis and into a direction in which development concerns do matter in deciding about the project.

Now, the suggestion that flows from all of this is that the most efficient way to provide finance so that the developing country can afford the project, but to not distort their preferences, is in fact to multilateralize the mixed credit process; to in fact create an agency within the World Bank. That would be the most likely place, that would have the responsibility to provide the subsidies to those more normally commercially oriented approaches.

The World Bank would then be involved in talking to the donors about the development viability of the project, rather than having people like ExIm Bank to decide whether or not it makes sense for the country that is buying.

Senator **Sarbanes**. Well, that is all well and good. But these countries are not playing that game. I do not accept your basic premise.

It is clearly serving their commercial advantage, and they are using it for that purpose, and they are doing it very skillfully; including telling people like you that this is all a development objective, and having you accept that proposition from then.

You have got to be kidding, when you look at these figures and the amount of money they are putting in. Now, to the extent they start to squeal if the figure gets up higher, because it is in fact proving costly to them, which you just alluded to. It seems to me that that runs directly counter to your argument.

To the extent they now are asserting that the 35 percent figure is getting them up at the margin, and if it goes any higher they do not want to go any higher—they are very resistant to it going higher and if it got up to 50 percent or 60 percent they may not be able to continue this practice. Why wouldn't they be able to continue this practice, if their purpose is developmental?

Mr. **Tucker**. I agree with you on that. That should be an objective.

Senator **Sarbanes**. The reason they then assert that they cannot continue the practice is because the commercial side of it stops working when they start getting up into those figures, and they cannot make it pay.

Mr. **Tucker**. It already has. That is the point; that they are in fact unwilling, if commercial gain is all that their objective is, they are unwilling to raise the grant element. They are showing signs that in fact they recognize the U.S. position on coordinating aid. That is, that we need to push this more into the development realm, and out of the commercial realm.

The 50 percent objective makes a lot of sense. The objection I have to pushing hard for negotiations in the next 18 months is that these countries have only had about a year-and-a-half to respond to the last change. As you well know, any government is going to be slow to change its practices, not because it is necessarily resistant, but because it takes time to shift the grounds on which they operate.

Senator **Sarbanes**. No, no. We have got to keep pushing on this thing. These companies are being knocked out of markets that they are entitled to be in on economic considerations. They are prepared to compete fairly, and they are being knocked out by the interaction of government and their competing businesses in other countries.

It is an unfair proposition, and we have to figure out how to address it. It cannot be done in the long run. By the long run, there will not be any long run. It is all over and done with: the markets are gone, the relationships are established, the follow-on contracts are in place, and the whole thing just flows from that. That is the problem we have been facing.

Well, my time is about up. I want to put a couple of questions to your colleagues on the panel.

Mr. Armenian, I think you hit it at the bottom of page 8 and the top of page 9, about the difference within the Administration between those who acknowledge the problem and want policies to address it now, and those who feel that a substantive policy response by the U.S. would exacerbate our constrained budget picture. That was even reflected by Mr. Dallara's response, even on a higher authorizing figure, let alone what would happen in the appropriation process.

I need not remind you all that it was this committee that fought tooth and nail to keep the ExIm Bank going despite the assault upon it by the Reagan Administration, first to do away with it altogether, and then to do away with it in pieces so to speak.

Senator HEINZ. Mr. Chairman, you are not including Senator Proxmire in that statement, are you? [Laughter.]

Senator SARBANES. I am not.

I am including you in the statement, though. [Laughter.]

And myself.

Were you encouraged by what you heard at the witness table this morning from the Administration witnesses? What was your reaction to that testimony?

Mr. ARMENIAN. Mr. Chairman, I was encouraged by the emphasis that I read in Mr. Macomber's testimony. He brings in experience, understanding, to the issue, and a renewed commitment that I sense in his attitude in responding to the situation.

However, I was not as encouraged listening to Mr. Dallara. Essentially, they were giving the same message, but the emphasis was different. If we are in fact to expect any success or any progress in the negotiations, it is very important that some of Mr. Macomber's enthusiasm be contagious and go over to the Treasury side. Because the Treasury people, the Treasury negotiators are the ones who will be making a point emphatically at the negotiation table.

Incidentally, the word "robust" that Mr. Macomber used is a French word, and it can come in very handy at the negotiation table, because that is a word that the French would understand.

Mr. KITTREDGE. Could I respond to that, also?

Senator SARBANES. Yes.

Mr. KITTREDGE. I was not encouraged. Frankly, I felt that they had come with the same old position and tried to dress it up in attempted new clothes. Really, the $100 million is the same old number. The way they approached it, I heard them trying to defend a position that I am not sure they believed in, frankly.

I was encouraged by Mr. Macomber's enthusiasm and his commitment, and we have seen that, our companies have, in work we have done with him. That is excellent. But my impression was that they really did not believe what they were saying.

Senator **Sarbanes**. Well, did not believe it in what sense? Let's assume that they have been given an OMB constraint.

Mr. **Kittredge**. Exactly.

Senator **Sarbanes**. Is it in that sense that they——

Mr. **Kittredge**. Yes, exactly. They had been given $100 million, and that was it.

Senator **Sarbanes**. Yes. Okay.

Mr. **Kittredge**. And they were trying to make the best out of that.

Senator **Sarbanes**. Is it your perception that within that constraint, the two people who were here really want to try to do something about it? Or, if they were not bound by that constraint, they would be moving more robustly and vigorously?

Mr. **Kittredge**. I was more sure of Mr. Macomber in that case than of Mr. Dallara.

Senator **Sarbanes**. Yes, all right.

Senator Heinz.

Senator **Heinz**. Mr. Chairman, you really have asked a lot of excellent questions. [Laughter.]

And I have no further questions as a result.

Senator **Sarbanes**. Well, gentlemen, this does not often happen. [Laughter.]

I want to move very quickly, then, to adjourn before Senator Heinz reconsiders. You have been a terrific panel. Mr. Tucker, you as well, although obviously I disagree with some of the evaluations you are making. But we need to keep that thought in mind.

I must say, I have some concern on moving too easily into the aid program and turning it into an economic development tool, and that needs to be addressed carefully.

But we have got to move on this problem. It has been very helpful to have this panel. We look forward to staying in close touch with you on this issue.

Thank you very much.

Mr. **Tucker**. Thank you.

Senator **Sarbanes**. The committee is adjourned.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

[Additional material supplied for the record follows:]

# STATEMENT OF

# THE BANKERS' ASSOCIATION FOR FOREIGN TRADE

on

# TIED AID CREDIT PRACTICES
# AND EXPORT FINANCING

SUBMITTED TO THE

SUBCOMMITTEE ON INTERNATIONAL
FINANCE AND MONETARY POLICY

UNITED STATES SENATE

SEPTEMBER 13, 1989

The Bankers' Association for Foreign Trade ("BAFT") is submitting the following statement for the record of the Subcommittee's hearing of September 13, 1989 on tied aid credit practices. BAFT was founded in 1921 by the U.S. financial community to promote sound banking practices in support of U.S. trade. BAFT's membership includes virtually all U.S. banks having significant international operations. BAFT also has international members from thirty-six foreign countries who are actively engaged in international banking and financing activities in the United States.

BAFT would like to commend the Subcommittee for scheduling its hearing on tied aid credit practices. Despite the OECD Agreement of 1986, use of tied aid credit practices by other countries has been increasing. Such practices severely harm the ability of our U.S. export customers to compete in developing country markets abroad. The United States needs a clearly defined policy to counter tied aid credit practices of other countries. However, the United States also needs a coherent policy for reinvolving U.S. banks in export financing. BAFT would thus like to present three sets of recommendations to the Subcommittee for its consideration:

**First, Eximbank needs a more flexible and aggressive approach to countering tied aid credit practices of other countries.**

**Second, changes and improvements are needed in Eximbank operations and programs to increase U.S. bank involvement in export finance.**

**Third, Congress needs to reexamine and remove disincentives in current and prospective laws to U.S. bank financing of exports.**

## The Need to Defend U.S. Exports Against Tied Aid Credit Practices

As bankers, we support the interests of our U.S. exporting customers and urge the Congress to establish a credible, consistent and selectively aggressive policy of countering tied aid credit practices of other countries to preserve U.S. export markets and to encourage further multilateral efforts to curtail such practices.

- It has been well documented in studies by Eximbank and by the U.S. exporting community that a significant amount of U.S. exports have been lost to tied aid credit practice of other nations. In addition to bids lost to heavily subsidized foreign competition, there are bids never made by U.S. exporters because tied aid practices have effectively closed certain markets abroad. These "hidden lost sales" may be several times greater than those that can be documented through the bidding process.

The impact of tied aid credit practices has been greatest on traditional capital goods sectors, some of which have been forced to move outside the United States to take advantage of other countries' mixed credits. This loss of productive capacity is harmful not only to U.S. output and employment but also to long-term U.S. competitiveness, as long-term investments in research and development end up being made in other countries. As the United States loses export industries, it becomes more dependent on industrial technologies developed by others abroad, a fact which has implications for our national security.

A more effective U.S. response to tied aid credit practices of other countries requires adequate budgetary support. BAFT believes the most effective way to provide this support may be through the approach put forward by Senator Heinz in S. 1217, the "Export Finance Expansion Act of 1989," which gives Eximbank greater flexibility to counter mixed credit offers from other countries. As Eximbank determines the best ways to combat tied aid practices of other countries, BAFT would be pleased to work with the Bank in determining what type of supportive role could be played by the U.S. banking community. For example, in the United Kingdom, British banks are actively involved in their country's mixed credit efforts, by extending credits whose interest rates are heavily subsidized by the ECGD. Depending upon budgetary and other considerations, it may also be worthwhile for Eximbank to explore these types of programs in the United States to counter tied aid credit practices of other countries.

## The Need to Increase U.S. Bank Involvement in Export Finance

### The Changing Face of International Finance

As members of this Subcommittee are well aware, the U.S. financial services industry is in a period of intense geographic and product restructuring. LDC debt problems, new risk-based capital guidelines, changes in tax rules, multistate acquisitions and a strong market emphasis on efficiency and profitability have caused banks to review critically their role in international finance and the types of international services they provide to their customers.

While painful to banks and, at times, their customers, this rigorous assessment of international activities has been healthy for the industry. International investments and activities must increasingly be justified by strategic and relationship-driven objectives and must satisfy certain basic performance criteria. Although this analysis has caused some banks to restructure and more narrowly focus their trade finance activities, to paraphrase Mark Twain, the reports of the death of export finance in the United States are greatly exaggerated. In fact, LDC debt problems, in causing banks to reassess their international role, have led many banks, especially regional banks, to put a renewed emphasis on trade finance as the international activity that most directly meets U.S. customer needs and thus fosters profitable long-term relationships.

While banks have a great desire to assist their customers, they nonetheless face a number of disincentives which make it difficult for them for provide export finance support on terms that are acceptable from a risk and profitability standpoint to their boards of directors and shareholders. A

House Staff Report[1] did an excellent job last year of reviewing these disincentives and we would like to bring to the Subcommittee's attention those disincentives which, through its legislative and oversight role, Congress can be most helpful in removing.

## The Need to Improve Eximbank Funding and Operations

As members of the Subcommittee are well aware, Eximbank's Direct Lending Program has withered over the past decade. In 1981, Eximbank's lending authority was $5.4 billion. This year's authority is $695 million and the House-passed appropriations bill would fund next year's levels at $595 million.

Adequate funding for direct loans is important not only for U.S. exporters, which need access to direct loans in order to compete in many markets abroad, but also for regional and smaller U.S. banks which use the Intermediary Loan Program to support exports of their smaller customers.

Because of budgetary constraints that have reduced direct loans, we believe Congress needs to explore other methods for supporting U.S. exports that (i) will minimize impact on the Federal budget and (ii) reinvolve U.S. banks in export financing transactions. In this connection, we would like to commend Senator Heinz for including provisions in S. 1217 that will improve the coverage and marketability of Eximbank guarantees and that will allow Eximbank to develop a workable interest equalization program.

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[1] "Export Financing in the United States: Problems and Options," Staff Report, Subcommittee on International Finance, Trade and Monetary Policy, U.S. House of Representatives, 100th Cong., 2d Sess. (1988).

First, although Eximbank's new programs allow for the transferability of Eximbank-guaranteed notes to secondary financial markets, the quality of Eximbank's guarantee with respect to interest coverage has not been conducive to attracting secondary market interest. As pointed out by Senator Heinz in his introduction of S. 1217, the present interest cover policies have been set by Treasury, which has been concerned that increases in interest coverage might cause the paper to compete with Treasury bills. We support provisions of S. 1217 which would give Eximbank the authority to set the terms of its interest coverage, so that this impediment to the development of a secondary market could be removed. We also support those provisions of S. 1217 that would give Eximbank the ability to extend coverage of the guarantee to timely payment of participations in securitized Eximbank-guaranteed loans, since this would also enhance development of the secondary market. An expanded secondary market would encourage U.S. commercial banks to expand their export finance activities by giving them the flexibility of holding or selling

Eximbank-guaranteed assets -- flexibility which is crucial to bank management in today's financial markets.

Second, as recognized in Senator Heinz's bill, another way to leverage meager budget allocations and bring more banks back into export financing is to give an interest make-up or equalization program a fair test. Any such program should supplement not supplant direct loans, and should be designed with input from the banking community to ensure it is both attractive and workable. Properly structured, such a program can expand the availability of export finance at less budget cost. In that connection, such a program will not achieve its intended "leverage" benefits unless the interest subsidy can be provided for Eximbank-guaranteed loans without triggering the scoring of such loans against the budget. It is thus crucial to the success of this program that the budgetary issue be resolved.

Increased funding is needed not only for Eximbank programs but also for Eximbank administrative resources, which are simply inadequate to deal with the range of programs being administered by Eximbank. Banks and their customers are often frustrated by delays in obtaining commitments or coverage, delays that can sometimes result in lost sales.

Delays have increased substantially since 1986 when the law was amended to increase direct access to Eximbank programs and to put more emphasis on assisting small business. We support those changes and objectives, but believe Congress needs to give Eximbank the resources to accomplish these broadened tasks in a more efficient manner. For example, we believe Eximbank is to be commended for its working capital guarantee program which encourages banks to make working capital loans to smaller U.S. businesses for export-related production and marketing activities. Banks that have used this program believe that with certain changes and more administrative resources, it can be made an extremely effective tool for reaching the new-to-export small firm.

Lastly, certain changes in Eximbank programs that were instituted in 1987 have greatly decreased their attractiveness to U.S. banks. In this connection, BAFT would like to recommend to the Subcommittee an Eximbank Advisory Committee Study on Reinvolving the Financial Community in Export Finance which contains a number of recommended Eximbank program changes for increasing U.S. bank involvement in export finance.

Eximbank has already responded to some of these recommendations. For example, to simplify bank use of its programs, Eximbank recently adopted a new Master Guarantee form which should help mitigate previous documentation delays on individual transactions. However, Eximbank has resisted other recommendations, such as reinstituting a 1% spread on medium-term loans in the $5 to $10 million range, which spread is needed to restore the profitability of these transactions for U.S. banks. It would also be helpful for Eximbank to reinstate a limited fee sharing arrangement, which would help banks' cover administrative and overhead costs involved in processing Eximbank transactions. While such changes may seem small, they could be extremely important in encouraging U.S. banks to participate more actively in export finance. In this connection, we look forward to working with Eximbank's new leadership on these and other program changes important to the financial community. While these recommendations are not areas for legislative action, this Subcommittee's oversight role on these and other program changes can be important in ensuring that Eximbank programs encourage U.S. bank involvement in export finance.

## The Need to Remove Disincentives To Export Finance in Other Laws

Last year's House Staff Report reviewed a number of U.S. disincentives to export finance. BAFT would like to focus on one change in the tax laws which has had a particularly damaging impact.

As a result of the 1986 Tax Act, U.S. banks are effectively denied tax credits on high withholding taxes which they pay on cross-border loans made abroad. These withholding taxes are generally imposed on private, not sovereign, loans. This change has thus had a significant impact on the cost of credit extended to buyers of U.S. exports in such countries. Since U.S. banks are no longer able to absorb the withholding taxes, they must pass them on to the foreign buyer, which additional costs often make U.S. exports uncompetitive. For example, one of our member banks financed a substantial number of U.S. commodity exports to Australia prior to the 1986 Tax Act. Since then, the bank and its customers have been effectively priced out of that market.

To remedy this problem, BAFT has recommended that the 1986 Tax Act be changed to allow the creditability of withholding taxes imposed abroad on export financing interest. Such an "export financing interest exception" ("EFI"), was proposed last year in legislation introduced by Senator Roth and Representative Gibbons. Enactment of an EFI bill would remove a major disincentive to U.S. bank participation in export financing.

Unfortunately, the House may be headed in the wrong direction on this issue. The House Ways & Means Committee has included a provision sponsored by Chairman Rostenkowski in its reconciliation bill that would repeal a transition rule for loans to the LDCs provided in the 1986 Tax Act. This transition rule has been important because it has permitted export financing transactions to the LDCs to go forward since 1986. Repeal of the transition rule would make these export loans unprofitable or would force banks to pass the increased costs on to their customers. BAFT thus urges the Subcommittee to oppose the inclusion of this House provision in any Senate reconciliation measure because of the adverse impact it will have on export financing.

## CONCLUSION

There is a great deal that Congress can do to encourage the financing of U.S. exports. It can give Eximbank the resources and flexibility it needs to counter tied-aid credit practices of other countries. It can give Eximbank the funds and operational flexibility it needs to support U.S. exports and reinvolve U.S. banks in export financing. And, finally, it can remove disincentives to the competitive bank financing of U.S. exports. BAFT urges you to do all three.

ASI

September 7, 1989

The Honorable John Heinz
United States Senate
Washington, D. C. 20510

Dear Senator Heinz:

The purpose of this letter is to bring to your attention a recent example of tied-aid and soft loans offered by foreign governments to their businesses when competing against U. S. companies in international tenders.

Aviation Systems, Inc. (ASI) is one of the few remaining U. S.-owned electronic companies competiting on a world wide basis for the electronic navigation aid business. The company recently responded to a solicitation (Licitacion International 004/89) issued by the Government of Colombia for four VHF Omnidirection Range (VOR) and five Distance Measuring Equipment (DME). The equipment is to be deployed at various airports throughout Colombia, to improve the safety of air navigation in that country.

Licitacion International 004/89, requiring 100% financing of the proposed equipment, closed on August 28, 1989. Two companies responded to the tender; ASI and Thomson-CSF, a French government-owned company. Results of the bid opening are as follows:

ASI
Price Quotation (CIF) - US 1,903,309.00
Financing - 15% of the program financed by ASI, at a rate of 8.65% fixed, with payment in 12 semi-annuals, commencing two years from contract signing. The remaining 85% of the program was addressed by preliminary commitment for a direct loan (No. P.C. 61100) from the Export-Import Bank, at a fixed OECD annual rate of 9.65% and 17 semi-annual payments commencing six months after completion of equipment installation (approximately 18 months after contract signing).

Thomson-CSF
Price Quotation (CIF) - 18,199,985 FF (US 2,753,610.00)
Financing - credit from the French government. Their financing terms consist of a 20 year loan at an annual rate of 1.75% with a five year grace period, commencing upon signing the finance contract.

**Aviation Systems, Inc.**
11300 W. 89th St./Overland Park, KS 66214 USA
913/492-0861 FAX: 913/492-0870
Telex: 705394 ASI KSC UD Cable: ASIKSC

Although ASI has proposed to Colombia a technically superior product at a substantially lower price, French government tied-aid has jeopardized our chances of selling the U. S. built navigational aid products to this customer. This situation is unfortunately a common occurrence in international competitions, whereby the U. S. manufacturers/ Export-Import Bank are unable to compete with concessionary financing offered by European government supported companies.

It is our hope that exposure of this situation will lead to some corrective action. Any assistance on the part of your Committee will be appreciated.

Respectfully,

AVIATION SYSTEMS, INC.

Earl D. Long

Earl D. Long
Chairman and C.E.O.

EDL/lu